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The Journal of SOCIAL, POLITICAL AND ECONOMIC STUDIES

Roger Pearson
General Editor
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Associate Editor

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The Vital Role Of Policy: Or "What Happened To Ballistic Missile Defense?"

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It is quite likely that President Reagan himself failed to recognize how fundamentally he was changing accepted political thinking when he made his now famous SDI announcement in March 1983. Throughout most of the period of the Cold War, governments had become accustomed to the nuclear stand-off usually referred to as Mutual Assured Destruction (MAD). Meaning of course that if either side were to use nuclear weapons, it could unleash such overwhelming retaliation from the other side, that all life on this planet would be endangered. The prospect may have been too awful to contemplate, but it is one that we all had to live with, and as the years passed the conviction grew that MAD was indeed a means of avoiding nuclear war. Thus when President Reagan suggested that there was another way of dealing with this situation, he totally disrupted accepted political thinking, and the policy staffs of most governments give the impression/hat they have not yet recovered from the shock.

Few members of the public are forced to contemplate the awesome responsibility placed on a Commander-in-Chief, if he were ever informed that an enemy had launched a missile at his homeland. If that enemy is known to possess nuclear weapons, it has to be assumed that the attacking missile is so armed. At that point MAD has failed and without a missile defensive system, there is no longer any way to prevent major destruction; the only responsive advice available, is to launch a counterstrike. It was this type of scenario that led President Reagan to seek other ways of dealing with the situation that could buy the decision maker more time to explore alternative options more fully, and possibly avoid plunging the world into chaos. To the vast majority of the American public the statement that in 1996 there is still no capability of intercepting even a single offensive missile launched against a U.S. city is ludicrous. Some will be vaguely aware of the ongoing debate about whether the priority should be on

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something called Theater Missile Defense (TMD), as opposed to National Missile Defense (NMD), but few would believe that after spending close to $ 50 billion over 13 years, there is still no defense deployed. Nonetheless it is all too true, and likely to remain so for a further 5 to 10 years.

This article examines the activities that have led to the present position and reviews what will have to be done to prevent yet further deterioration of the situation.

The Role of Policy

It is almost too simplistic to suggest that without a clear policy programs will flounder. Yet despite the obvious truth of such a statement, the U.S. Ballistic Missile Defense programs have proceeded without clear policy guidelines for several years. There appear to be at least five criteria which have to be met to enable any democratic nation to move forward effectively with a major new defense effort. These are; an undisputed recognition of a threat, a military requirement to counter the threat coupled with the necessary technical capability, public and government support for the activity, a financial commitment to complete the work, and freedom to proceed under existing international treaties. In the area of BMD the only nation that has met these criteria is Israel, and there is every likelihood that they will be the first nation to deploy a non-nuclear missile defense system. They have reached this position faster, and at considerably less cost than the U.S., by choosing a single policy and sticking with it.

In contrast the U.S. work has been subject to regular substantial changes of direction without being able to settle into a well established program. The Strategic Defense Initiative was initially a research program designed to ascertain whether it would be feasible to defend against the vast number of warheads that could have comprised an attack by the Soviet Union. As the research developed it was recognized that the engineering associated with the directed energy systems, the only means capable of dealing with such an attack, would take far longer to develop than the 10 or so years first estimated. So the major effort was redirected towards less exotic kinetic energy interceptors, leading to the first strategic defense architecture devised in 1987. This Phase 1 architecture fell well short of the President's original objectives. It lacked the capability of

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intercepting missiles in their ascent phase, and would only have provided support to deterrence, by significantly reducing the effectiveness of a first strike option.

Not long after this program was approved, it became obvious that the Soviet Union was not only incapable of competing with SDI, it was in danger of total collapse. This meant that the threat was likely to degenerate into one of unauthorized, or accidental launches, rather than a massive attack. A recently conceived device called Brilliant Pebbles, BP seemed to be tailor-made for countering this form of attack, and led to the development of a new architecture in 1990 called Global Protection Against Limited Strikes (GPALS). This was conceived as a means of dealing with unauthorized or accidental launches from the Soviets, or the more limited attack that could be mounted by another nation. The BPs were to be space based autonomous interceptors capable of intercepting attacking missiles early in their flight path. The concept of a comprehensive suite of weapons circling the globe and capable of destroying missiles launched from anywhere; which was how the system was interpreted, proved unappealing. The whole concept of putting interceptors in space, whether or not they incorporated explosive warheads, appeared to be well beyond anything world opinion was then prepared to accept. GPALS was not accepted by Congress, and was subject to quite strong criticism in most other capitals. Before leaving Office, President Bush wrote in February 1992 to the leaders of over 20 friendly countries, inviting them to cooperate with America on GPALS. Apart from elevating the topic of BMD to Cabinet level attention for a short period of time, this invitation had no discernable effect on allies, and as far as can be ascertained, none accepted the invitation. This architecture too was soon designed to change, as global defense moved to a lower priority.

Following the Gulf War and the election of President Clinton strong statements of support were made for Theater Missile Defense (TMD). This led a humourist to suggest that Saddam Husain could be viewed as "the Father of the U.S. TMD program." Regardless of who was really responsible, the TMD activity received significantly enhanced funding, and became the lead program, relegating National Missile Defense (NMD) to back up research. The SDIO was renamed BMDO (Ballistic Missile Defense Organization), to reflect the changed priorities. Later, a Bottom Up review was conducted, which

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approximated to a full Defense Review, and confirmed the high priority accorded to TMD. The Presidential words of encouragement for the program were not however matched by financial allocation, nor by active White House support. Indeed, much more effort appeared to be directed towards reaching an agreement with Russia, and the newly freed ex-Soviet republics, which if successful, could have significantly constrained U.S. missile defense capabilities. This put the Administration in conflict with Congress, a situation that escalated significantly in late 1994 when both Houses were captured by a Republican majority. Congress has since attempted to bring NMD back as a mandated development program, with a projected date for deployment. So far this has not been successful because the President has been prepared to veto such legislation.

This brief review of the changes which have been imposed on the U.S. missile defense activities over the past 13 years, indicates clearly that the criteria required for the successful completion of a major new defense program have been notably absent. The Administration and the Congress cannot even agree on the threat, so it is hardly surprising that the Research and Development program has lacked stability. The organization charged with responsibility for managing the program, initially SDIO now renamed BMDO, has had to operate in a virtual policy vacuum.

The International Situation

For more than forty years America's allies have sheltered under the umbrella of extended deference. Britain and France may have independent nuclear capabilities, which during the cold war would have complicated Soviet strategic planning; but in terms of true deterrence, the West remained under the protection of the U.S. The original announcement of the SDI program, sent shock waves through many allied governments. They visualized a totally changed strategic situation in which the U.S., secure behind it's new missile defense, would no longer feel compelled to launch a nuclear strike in retaliation for an attack on an ally. This emotional reaction was partly responsible for the initial allied hostility towards SDI. It should not be forgotten that in the mid 1980s the only threat appeared to come from the Soviet Union. Nuclear deterrence may have been highly unpopular, but to most allied governments, it appeared to be working, and was certainly superior to a totally new, and unproven, security

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policy.

The world has now passed from a hostile, but stable Cold War situation, to a far more uncertain state in which Governments lack the political and historical experience which guided their policies over the past 50 years. These considerations colored European attitudes towards missile defense, and have made it much more difficult for allies to view the subject objectively. While political leaders may be prepared to acknowledge that proliferation has increased significantly, it tends to be viewed as a risk rather than a threat. Particularly since the location and the range of most current offensive systems, other than those possessed by Russia, precludes them offering an immediate threat to European population centers. When these many factors are added to the doubts which have been expressed regarding the likely efficacy of a BMD it is hardly surprising that most Administrations have been reluctant to allocate scarce resources to a program they consider barely necessary, and possibly ineffective.

Despite the strenuous efforts successive American Administrations have made to inform friends and allies of progress on BMD research, most still have little real appreciation of the subject. They do however pay close attention to internal U.S. defense issues, and note the frequent changes in program priorities, and the ongoing disagreements on major issues of BMD policy. From an uncommitted observers viewpoint, the program is far from stable, and not one which appears attractive, or worthwhile joining at this stage.

Despite the lack of an agreed threat to European population centers, the events of the Gulf War demonstrated clearly that troops sent to crisis areas are going to need defense against missile attack. Because of economic pressures most governments have been slow to acknowledge this publicly, and the moves which have been made have been low key. An international MEADS (Medium Extended Air Defense System) program was started, initially with French, German, Italian and American participation. While the specification of the system was in the process of being agreed, the French withdrew from the program, leaving it's future in some doubt. MEADS is envisaged as a tactically mobile weapon capable of engaging cruise missiles (CMs) and short and intermediate range ballistic missiles (BMs). As a point defense system it would have limited capabilities for area defense, unless supported by an upper tier. This could only be supplied by America or Israel, since no other country has suitable

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systems in an advanced state of development. The recent revision of the U.S. BMD development, announced in early 1996 by Paul Kaminiski, has taken some $2 billion out of the Theater High Altitude Area Defense (THAAD) program over the next 5 years. This will reduce the standard of the missile and is likely to delay it's full entry into service for a further 10 years. Whether or not this change influenced the French attitude towards MEADS is uncertain.

It is somewhat ironic that Congress having earlier zero-funded the MEADS program, was persuaded by DOD to reinstate the funding to avoid disrupting the only international TMD program currently in development. It is also noteworthy that just as the French withdrew from the program, the U.K. were receiving their own Pre-Feasibility Study, conducted by industry. This study is bound to highlight the missile risk to the Rapid Deployment Force, and is likely to recommend, that at the very least, some TMD resources are made available for it's protection.

It is clear that at this stage the European allies are even further removed from an agreed BMD policy than the U.S. Economic issues loom large in Europe, and most governments seem fearful of acknowledging a threat before being confidant they will be able to afford to counter it. From the early days of SDI it seemed clear that the only national leaders who really understood the full ramifications of the concept of missile defense, were President Reagan, President Gorbachev, and Prime Minister Thatcher. Of the three, only Lady Thatcher still commands worldwide attention, even though she no longer holds office. During her address at Westminster College, Fulton, Missouri in March 1996, she made it abundantly clear that the West must install a BMD, that would protect us and our armed forces against the growing risk of missile proliferation. Lady Thatcher made that address on the fiftieth anniversary of Winston Churchill's Iron Curtain speech. There is every reason to believe that Lady Thatcher's statement will re-echo in the same manner as Churchill's, if her warning is not heeded. The real problem still to be solved is to convince current Western Government leaders that an effective BMD can be afforded. In our opinion, that can only be achieved through international cooperation with real leadership from the U.S.

If we look beyond Europe, the situation is just as confused, even though in some cases the threat is certainly more imminent. The Japanese have begun to review the defense posture they have held

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since the end of the second World War. But even if changes are introduced they will not be made quickly. Until now they have maintained limited capabilities across the board, which would be unable to cope alone without U.S. support. The U.S. is now assisting on a Japanese funded study to determine what course, if any, Japan should take with respect to TMD. To the Japanese, missile defense means strategic defense of their homeland against BM and Cruise Missile (CM) attack. The threat might be the same as that which the U.S. defines as Theater, but to Japan, as to Israel and to much of Europe, the desire is to protect strategic assets. Upper tier, longer range interceptors, would be an essential component of such a defense, in which the lower tier elements contribute important, but complementary support.

The recently announced changes to the U.S. program have, as noted earlier, degraded and delayed the availability of THAAD, currently the only U.S. upper tier interceptor in advanced development. This at the same time as the Chinese were launching missiles towards Taiwan, in what turned out to be a vain attempt to influence elections. One of those missiles is reported to have landed within 60 km. of Japanese territory, perhaps reminding them that the threat is here and now, rather something that might arise in the future. With their traditional reliance upon U.S. equipment, the Japanese will be unable to deploy an effective defense against these threats for at least a decade, unless they are prepared to consider alternative suppliers.

South Korea, Singapore, Taiwan and Australia, are all reported to be showing more concern about the growing missile threat, as proliferation of systems and technology continues to spread. However if the examples of Europe and Japan are followed it will be several years before these countries decide on a policy for countering the threat.

The Status Of Technology

Perhaps the most frustrating aspect permeating the topic of BMD is that policy considerations appear to have lagged so far behind technology. The research programs supported by the U.S. over the past 13 years have yielded significant advances. The developments have demonstrated that an effective defense could be deployed against the limited threats that nations other than Russia could

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employ.

The initial research program, started under the SDI banner, proved to be far too ambitious. It was an attempt to devise a defense that could defeat a massive attack consisting of thousands of warheads intermingled with tens of thousands of decoys, making the choice of targets alone a herculean task. It was correctly deduced that the only way of countering such an attack would be through the use of particle beams and laser weapons. At the present time, these systems can only be designed to operate effectively beyond the atmosphere, and the engineering required to deploy and operate them remotely in space proved to be beyond current capabilities. It was the initial concentration on these weapons that led to the coining of the phrase "Star Wars". Once the research revealed the extreme difficulty of developing such systems, priority was transferred to the development of more conventional components and these have been far more successful.

The fall of the Soviet Empire has been followed by a significant increase in proliferation of both missile and unconventional warhead technology. Instead of facing one well known opponent, capable of mounting overwhelming attacks with weapons of mass destruction, the potential threats now arise from a number of different countries, each of which has far more limited resources. In other words the threat to be countered became much more compatible with the technology being developed to deal with it. The threat, as demonstrated by Iraq during he Gulf War, is not something that may develop in the future, but has been with us for several years and grows steadily worse. The basic elements of a defense to counter the current and emerging threats consist of sensors, interceptors, and a battle management and information system (BMC3I), capable of ensuring that all the components can operate effectively as an integrated system. To be effective the sensors have to be capable of detecting and tracking offensive missiles almost from their moment of launch, until they are intercepted. This means that the early warning and tracking has to be accomplished by space based sensors, which have the ability to hand off track file data to ground based components as the battle develops. The U.S. leads the world in these sensing capabilities, and has the potential to fulfill not only it's own requirements, but also those of its allies that are prepared to allocate appropriate resources to the provision of interceptors for their own protection. The Defense

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Support Program Satellites have long provided a reliable means of detecting and locating missile launches. Research programs under the direction of SDIO, and later BMDO, have demonstrated the ability to track offensive systems and pass appropriate information to command centers on the ground. Thus there is no longer any doubt regarding the ability to acquire, track, and hand off information on hostile BMs.

Turning to interception, the successful trials of the ERINT missile, demonstrated that hit-to-kill is an achievable objective. The ERINT is now in engineering development as the selected update for the Patriot system to bring it to the Pac 3 standard. In dealing with warheads of mass destruction, it becomes vital to destroy rather than just damage the attacker. Until the developments recorded in the SDI program, the only sure way of destroying the contents of a warhead was to intercept it with a nuclear device mounted on a defensive missile. This is still the basis of the current Russian ABM system, which was installed round Moscow by the Soviets in the late 70s and early '80s, and remains operative. By virtue of the fact that it relies upon large nuclear detonations in the atmosphere to"provide strategic protection", it has to be considered a system of last resort.

The Patriot system intercepts well within the atmosphere, and is referred to as lower tier, or point defense. This means that it can defend only small areas on the ground, and is not suitable for the defense of large population centers. The center piece of the TMD architecture now being developed is the THAAD missile. This has been designed as an upper tier hit-to-kill interceptor, capable of engaging attacking missiles beyond the atmosphere. Because of it's long range it can provide area defense. The lower tier complements the THAAD by intercepting those missiles which are not successfully intercepted in the first stages of the engagement. Thus the two systems cooperate together to provide a highly effective defense. The only problem with the scenario just described is that the U.S. program was revised in early 1996, by the removal of significant funding from the THAAD program, to finance other activities. Thus while the Pac 3 should become available for deployment before 2000, the design standard and the availability of THAAD is more problematical.

The glue which holds the whole system together is the Battle Management, Command, Control, Communications and Intelligence,

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more easily referred to as BMC3I. This is a vital, but far less glamorous entity, which tends to be the poor relation in most projects, until they get closer to deployment and it becomes apparent that more resources have to be allocated to this area. BMD was given a great advantage by the foresight of the first Director of SDIO, LTG J. Abrahamson, who established two major test facilities for the development of BMC3I. One is the National Test Facility and the other the EADTB. These have provided the means to simulate the conditions that would be encountered in a real engagement, and ensure that the systems under design will perform adequately.

In summary the technology, although not fully developed nor fully proven, has moved much further and faster than the policy. The latter is still much closer to the bipolar, cold war dominated world we have left, than to the unstable, multi polar world in which we now find ourselves. As is so often the case, policy-makers, overly concerned that a change might prove to be wrong, prefer to do nothing until events force them in a particular direction. Returning to the thoughts of our humourist, we have to wonder who will become known in the future as the Father of the National or Cruise Missile Defense by unleashing an attack in the future that finally causes an Administration to take the problem seriously. It will be appallingly tragic if it really does take such an attack on a major city to persuade the Government to deploy a system that could have prevented the tragedy.

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Taiwan: An Emerging Hub for the East Asian Regional Economy

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Tremendous strides are being taken toward closer cooperation among the dynamic economies of the Asian and Pacific region. Greater economic integration among the market-oriented economies has been a steadily evolving trend over the past decade, with attendant benefits for all concerned in terms of commercial, cultural, educational, technological, and security interests. It is the role of Taiwan in this process that I wish to survey in this paper.

Increased Trade Within the Asian/Pacific Region

Cooperation and policy coordination make a great deal of sense in a dynamic, rapidly changing region like this one. Over forty percent of total world trade takes place in Asia and the Pacific, and growth rates for exports and GNP in this region dramatically exceed the global average. Significantly, Asians are trading more and more with each other as their national economies expand. According to a study released by the Carnegie Endowment for International Peace, forty-two percent of Asia's trade now takes place within Asia. Moreover, foreign direct investment in Asia is now primarily intra-regional. Today, Asians themselves account for seventy percent of all foreign direct investment within Asia.

In this context, the Republic of China (ROC) recognizes that its economic future is intimately linked to that of its neighbors, and to the success of the region as a whole. Consequently, it is committed to participating actively in all councils of deliberation on Pacific regional affairs including the ADB, PBEC, APEC, and PECC.

Taiwan as a Link Between the Northeast and Southeast Pacific Regions

To help fulfill the aspirations of the people of the ROC to play an important role in the international community, and to help secure

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their economic future, the country is now transforming itself into an Asia-Pacific Regional Operations Center (APROC). Taiwan is uniquely positioned in every sense to become the natural hub for region-wide commerce and information exchange in Asia and the Pacific. Its basic global and regional networks are already established, and it is currently engaged in necessary policy adjustments to further promote this goal.

The government of the ROC is liberalizing trade and investment regulations to lower tariffs, remove non-tariff trade barriers, and open up the service industry. We will be easing restrictions on capital movement to liberalize foreign exchange control in stages. Furthermore, we are intent on establishing a modern legal environment for the new "information society," including full protection of intellectual property rights. Ultimately, we believe that Taiwan will play a pivotal role in regional economic integration, while also serving as a bridge between mature and developing economies.

Consider, for example, Taiwan's central geographic location in the heart of the region. Not only is it near to or astride most of the important trade and transportation lines in this region, it also serves as a natural link between Northeast and Southeast Asia in a commercial as well as geographical sense. Its trade with the six ASEAN nations climbed to US$19 billion in 1994. For the same year, commercial channels across the Taiwan Strait were estimated at US$17 billion. Consider also the distinctive cultural and historical connections which we of the ROC, as free enterprise practitioners, have with the rest of Asia. Chinese entrepreneurs throughout the region maintain substantial commercial and social influence in their local communities.

Taiwan as a Pivotal Regional Center

Taiwan's own successful entrepreneurial and democratizing experiences have established a positive, stable example for others to aspire to. All its citizens are prospering through an equitable distribution of wealth in a vibrant economy. We believe our neighbors view Taiwan's exemplary system as a "gateway" to their own further development. By virtue of all these factors, as well as others, the government and people of the ROC hope to persuade both local and foreign companies to look to Taiwan as their operational base for regional operations. Let us examine the basic components of the

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envisioned Taiwan economic center:

Manufacturing

Taiwan proposes to become a regional center for high value-added manufacturing including research and development. training and maintenance and technical support. Multinational firms frequently see Taiwan as an important location in this region because of its abundant supply of highly-skilled technical and managerial professionals; its sound and competitive industry infrastructure; its low investment risk; its stable economic growth and strong financial availability; and favorable government policies to support high-tech industries.

In fact, the ROC government would like to transform Taiwan into a "science and technology island." It will encourage research and development by establishing up to 30 new intelligent industrial parks in the next decade and facilitating their interaction with the traditional industrial zones. Taiwan's potential is increasingly apparent. Some of you may know that Taiwan already is the fourth-largest semiconductor manufacturer in the world, after the U.S., Japan, and Germany. Moreover, production of electronics and electrical machinery have grown nearly 200% over the past decade. Taiwan's computer industry's productivity increased ten-fold during the same time frame.

Transportation

Taiwan proposes to become a regional hub for sea and air transportation the lifeblood of all international business. Its beneficial central location can facilitate the transshipment and distribution of sea and air cargo, as well as passengers, around the region. To this end, we now have several initiatives under way. Several zones around the island already have been identified for meeting specific needs of different transportation operations. Kaohsiung Harbor, which currently ranks as the third-largest container transshipment port in the world, will become home to a fifth container berth and a future deep water harbor. The wharf at Keelung Harbor will be improved, and new highways connecting these ports with the outside will be constructed. Expansion of Taichung's harbor entrance, and development of a Taichung Harbor Industrial Zone, are also planned. An offshore transshipment center to allow foreign ships to transport

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cargo between Taiwan and the China mainland was recently established, so the cargo does not clear through its customs. For practical purposes, this overcomes the difficulties arising from the ban on direct transportation across the Taiwan Straits.

Air cargo transport facilities at CKS and Kaohsiung International Airports will be expanded for larger capacity. Moreover, CKS Airport potentially will become an Asian-Pacific air cargo transfer and warehousing center.

Financial Services

Taiwan also proposes to become a regional center for financial services. Liberalization and internationalization measures in the financial services sector began in the early 1980s and have created an environment suitable to development of a regional banking center in Taiwan. Restrictions have been eased in several areas. Offshore Banking Units have been allowed since June 1984, and earned interest is tax exempt. So far, approximately 40 banks have set up and operated these Units, with combined assets of some US$30 billion. Over time, we will emphasize deepening and broadening our foreign exchange market, our offshore banking unit and our foreign currency market to attract foreign financial institutions, thereby enhancing Taiwan's position as a regional funding center.

Communications & Media

I want to turn now to those operations with which I personally have had the most direct professional contact: media and communications services. I do believe that Taiwan is destined to become a regional service center for telecommunications and media activities. In fact, a truly revolutionary "information explosion" in the media already has occurred. For example, some 280 newspapers have registered with the Government Information Office since the ban on registrations was lifted eight years ago; and the number of radio stations is approaching 200, an all time high. Moreover, more than 70 percent of households in Taiwan already can select television programs of their choice from among nearly 70 channels broadcast daily through cable TV systems. Of the 70 channels, approximately 45 are coming down from the satellite. Taken together, this is a communications revolution of tremendous proportions.

The ROC government already has developed a secure

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telecommunications infrastructure for delivering basic services. For example, the Directorate General of Telecommunications has fully digitalized its entire international gateway exchange capacity. We intend to open up the domestic telecommunications market step by step, further improving the quality of services and eventually developing a national information network with a high level of efficiency. We will develop a switch traffic hub and a customer service center to better meet the needs of telecommunication throughout East Asia.

Efforts to develop Taiwan as a regional media center currently focus on two specific areas: print media and commercial film and video production. In the near term, Taiwan wants to develop as the region's principal location for production and distribution of Chinese-language TV programs and films, and as an important source of programming for the entire region's satellite and cable broadcasting industries.

According to studies by experts, the market value of Chinese-language television, cable television, and movie productions in Taiwan, Hong Kong, and mainland China amounted to $2.8 billion in 1993. Taiwan had the highest share at 47 percent ($1.3 billion), followed by Hong Kong at 28 percent ($800 million), and mainland China at 25 percent ($700 million). Now, by the year 2000, if we assume that the Taiwan and Hong Kong media markets continue to grow at an annual rate of 5 percent, cable television household penetration will probably exceed 60-80 percent (60% in the case of H.K. & 80% Taiwan). Moreover, if we assume that mainland China's purchasing power will grow by 7 percent annually, while its movie and TV markets will grow by 0.35 percent of that rate, then the total production value of Chinese language movie and television markets in Taiwan, Hong Kong, and Mainland China could be as high as $14 billion – fully five times that of the 1993 production value. It is easy enough to see that if Taiwan does its best to maintain its present market share of 47 percent, the rewards will be high indeed. Even if such a high share becomes difficult, a smaller share will still prove very valuable.

This will be an important step toward developing the Taiwan area as a sophisticated Asia-Pacific Media Center and it will be an integral factor in promoting a pluralistic, open, and globalized media industry. Improvements in both services and facilities are planned,

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including a new high-tech mediark using the latest in audio-visual and computer technology. In the process, we are hoping to lure media industries to invest in Taiwan.

Overseas Investment

Why should overseas investors be attracted? To begin with, Taiwan's media climate is completely open and free; therefore operational capabilities are almost unlimited. Just as important, the accessibility to its new media and telecommunications Center by foreign investors is ample. Moreover, the prospect for generous profits is outstanding, considering the potential growth and market share projections I cited previously. What a tremendous opportunity this is for U.S. investment capital, not to mention for U.S. broadcasters and entertainers. And no less important, in my view, is the fact that the broadcasting industry – "transnational" by nature – is becoming a critical bridge for promoting international understanding and cooperation in a "borderless" age. The Taiwan Center will become a significant bridging mechanism for enhancing cultural exchanges throughout the region. These are worthy objectives with which all of us can identify.

Still other considerations favor Taiwan as an Asia-Pacific regional media center. For one thing, one quarter of the world's population constitutes a market for Chinese-language information and entertainment programming, including Mainland China and Southeast Asia which both will become a global focus of economic development in coming years. Obviously Taiwan's centralized proximity to this market is a highly practical advantage.

Moreover, the advanced degree of socio-economic development on Taiwan will prove a real asset to the cultivation and enrichment of media operations. Political reforms over the past decade have made the ROC society one of the most free, open, and democratic systems in Asia, and certainly among Chinese-speaking communities. The liberal and diversified climate there will surely stimulate communications operations, as will Taiwan's high literacy rate, rich linguistic resources, and vibrant mass media. And as one of the world's largest and wealthiest economies, Taiwan itself will remain a stable, high consumption market for information and entertainment programming – a factor certain to attract overseas producers. Most important of all, the ROC is ready to proceed. Its present stage of

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media development, continuously updated by the application of additional technology, offers ready potential for integrating regional satellite and cable television systems for the benefit of future electronic broadcasting programming.

Eighteen months ago, the ROC's Government Information Office established an Advisory Committee of experts from industry, government, and academia to study, consult, and evaluate issues regarding the proposed Media Center. On the basis of those recommendations, additional specific measures will be taken to implement projects to construct and develop no less than two media parks financed in Taiwan.

Prospects for the Realization of the APROC Concept

Overall, I believe the planning for the APROC concept has been comprehensive and proportionate to ROC resources and capabilities. Ultimately, its full implementation is sure to create a balanced and mutually complementary network of centralized operations encompassing finance, manufacturing, sea transportation, air transportation, telecommunications and media operations.

Incidentally, in an indirectly related development barely two weeks ago, important new steps were taken by the ROC government to further liberalize investment and guarantee fair competition in its telecommunications sector. Following consultations with U.S. representatives, Taipei is publicly committed to remove remaining barriers which were seen as inhibiting U.S. and other foreign companies from entering the telecommunications market. Among steps agreed upon are the DGT will initiate the procedure to remove a proposed 11.5 percent cap on profits for the wireless telecommunications license process; and relaxation of the existing debt/equity ratio for bidders for wireless services.

Although not formally part of the official APROC development process, this agreement does play a role in ensuring that Taiwan's telecommunications sector is offering global services at a competitive price to both commercial and private users. As a net result, this agreement will provide Taiwan with even more of the technology and capital it requires to establish a genuine regional Media Center.

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How Good is Your Country? What You Should Know

Raymond B. Cattell, Ph.D., D.Sc.

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International Political Economy "After" the Business Cycle

Steven Weber
University of California, Berkeley

Business cycles – concurrent expansions and contractions of activity across many sectors of an economy – have been associated with significant changes in modern international politics and economics. International political economy makes significant assumptions about the cyclical nature of economic activity. Many of the central problems that IPE theorizes about are set in the context of a world with vibrant business cycles. But there are empirical and theoretical reasons to believe that the business cycle in advanced industrial economies is at the end of the 20th century being damped out, and that economic activity will fluctuate less violently in the future than it did in the past. The dampening of business cycles will have important consequences and implications for practical and theoretical issues in IPE – including (but not limited to) low inflation political economy, North-South relations, government policy, and the role of international institutions.

Western political economy since the industrial revolution on aggregate has been a vibrant world of rapid growth and development, at least for countries in the industrial "core". But it has also been a world of continuing and sometimes massive fluctuations in economic activity. Business cycles – concurrent expansions and contractions of activity across many or most sectors of the economy – became a taken-for-granted fact-of-life in this world.

The modern social science of international political economy (IPE) shared in basic assumptions about cyclical economic activity. The problems of conflict and cooperation between states that IPE theorizes about are generally set in a world of vibrant business cycles. Hegemonic stability theory grew out of Charles Kindleberger's arguments about the requisites for provision of a market for distress goods, a lender of last resort, and other "collective" goods *during the great depression*. Regime theory developed in the context of gradually declining American power, upon which were superimposed energy

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price shocks which brought *recession and "stagflation"* to the core. Studies of the international politics of exchange rates generally assume that states at any given moment want to do different things with their currencies and that their preferences at least partially conflict.

This paper asks the question, how would international political economy – the reality, and the social science – look different if business cycles were severely dampened out, if fluctuations in economic activity were subdued. The question is more than a thought experiment. *There are empirical and theoretical reasons to believe that the business cycle in advanced industrial economies is being damped out and that economic activity will fluctuate less violently in the future than it did in the past.* Obviously, there is no way to prove the truth of this statement. What I can and try to do, is to establish the strong plausibility of the argument on theoretical grounds and with some empirical support. If it is possible (likely?) that business cycles will be subdued, it makes sense to consider consequences and implications of that scenario for international political economy. Some of those consequences and implications are novel and at odds with widely held beliefs and expectations.

The first section of the paper "defines" what a business cycle is. The second section explores some of the roles that business cycles play, often implicitly, in modern theories of IPE. The third section takes a step back to review several major arguments about why business cycles happen. I then discuss the "future" of the business cycle in three steps. Step 1 looks at some peculiarities in the current cycle – mainly, statistical indicators that don't make sense in the context of traditional arguments. Step 2 is a fictional tale focusing on what could be different in modern economies that would counteract driving forces behind business cycles. Step 3 extracts six specific things about the modern world economy that I believe contribute to the muting of the cycle, and presents arguments and evidence that each is indeed having that effect. In the final section of the paper, I discuss several important consequences for IPE. The conclusion considers some objections to the argument in the form of possible "de-railers" to the picture I have presented.

What is the Business Cycle?

There is no single definition of the business cycle. Economists

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often use as a baseline some version of a 1946 statement by Mitchell and Burns:

> Business cycles are a type of fluctuation found in the aggregate activity of nations that organize their work mainly in business enterprises: a cycle consists of expansions occurring at about the same time in many economic activities, followed by similarly general recessions, contractions, and revivals which merge into the expansion phase of the next cycle.

This definition reflects the descriptive (rather than tightly analytic) nature of the concept business cycle. So do the terms used to label the four "stages" that make up a typical cycle: prosperity , transition, depression or recession, and recovery. The archetypal business cycle narrative connects these four stages temporally.[1] During the prosperity phase, the economy is operating at or close to full capacity. Increased lending by banks and spending by some combination of consumers, firms and government drives up aggregate demand. New jobs push the workforce toward full employment. But eventually growth slows and the economy slips into the transition phase. The increase in demand for loans will cause interest rates to rise above the expected return on some proposed investments. Wage demands exceed gains in productivity. Production inputs become more expensive. As the costs of doing business increase across the board, the profit margins of firms begin to fall. Some firms lay off workers and the rate of investment declines as businesses concentrate on selling off inventory rather than developing new ideas and products.

The economy moves toward the trough of the cycle, a recession or depression depending on its severity. Demand slackens as consumer borrowing and spending slow down. Firms postpone capital spending and try to streamline production by laying off more workers. The general mood becomes increasingly pessimistic as employment, income, and demand continue to decline. But eventually the decline in demand levels off. Wages and prices adjust as workers and firms respectively recognize their shifting positions on supply and demand curves. Interest rates move downwards, usually

[1] That is, without a strong account of causality.

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because of government action as well as diminished loan demand. Investment starts to pick up as inventories run down and predicted marginal returns on new projects exceed the costs of borrowing. Businesses start to buy more inputs and more labor. New jobs spur consumer optimism that in turn induces increased spending. The boost in demand will bring the economy back to the prosperity phase. The cycle will start over.

Business Cycles in International Political Economy

Business cycles have been associated with significant changes in modern international politics and economics. The depression at the end of the 19th century marked the end of an historic era of advancing free-trade (which began in 1815 with the repeal of the Corn Laws).[2] Although Britain held out for freer trade, Germany and America moved decisively toward protection. An accelerated shift in world economic power away from Britain and toward the US and Germany laid the groundwork for conflicts that would culminate in world war.

The great depression of the 1930s saw the modern heights of nationalist defensive protectionism and the near-collapse of international trade. The gold-exchange standard disintegrated in competitive devaluations and fragmentation into competing monetary blocs. International finance was manipulated by national authorities to serve state mercantilist goals. This depression tore apart international cooperation, facilitating the rise of illiberal and vehement nationalist ideologies that contributed, in turn, to another world war.

The oil shock and ensuing stagflation of the 1970s brought massive change to international trade and finance. The increasing cost of energy forced energy importers to compete more intensely for export markets, and (for many) to borrow massively from states and banks. Debt crises and a "lost decade" for many LDC economies were a partial result. In the North, inflation was accompanied by contractionary monetary policies and slow growth, boosting

[2] Industrial production expanded greatly during this falling-price boom period, although with severe fluctuations. Average annual growth for industrial production 1873-96: US, 4.9%; Germany, 4.2%, Britain, 2.1%. W. Arthur Lewis, Growth and Fluctuations 1870 - 1913. Boston : G. Allen & Unwin, 1978.

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protectionist forces.[3] The Bretton Woods system came finally to an end, *de facto* in 1973 and then *de jure* at the Jamaica Conference in 1976. Partly in response, the G-7 was created in 1975 and the European Monetary System in 1979.

These are only a few examples of how business cycles and major shifts in IPE have been connected in time. They are not intended as causal arguments. But there are theoretical bases for causal connections, some of which I consider below. The basic point is that many central problems of cooperation and conflict between states that IPE theories address, are closely tied to business cycles in those states.

Consider some basic examples.[4] Open trading systems are often modeled as a collective good, because the unilateral incentives of individual states are to free-ride and/or exploit the liberal policies of others. Hegemonic stability theory is the classic realist solution.[5] In Kindleberger's formulation, the hegemon plays a crucial role in establishing the norms and rules of a liberal system as well as "paying" or coercing others to join it, but most importantly in maintaining the system in the face of crises. As he put it "for the world economy to be stable, it needs a stabilizer, some country that would undertake to provide a market for distress goods, a steady if not countercyclical flow of capital, and a rediscount mechanism for providing liquidity when the monetary system is frozen in panic".[6] While there are other complications to hegemonic stability in the long term, the immediate challenges that the hegemon must face come in large part from business cycles – massive fluctuations in economic activity that "create" distress goods, cause rapid repatriation of capital, and set off financial panics.[7]

The maintenance of an international monetary "system" is another

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[3] W. M. Corden, "The Revival of Protectionism" Occasional Papers No. 14. New York: Group of Thirty.

[4] I am, naturally, not trying to cover in this discussion all theories of IPE, just some major arguments in order to show the impact of business cycles.

[5] It is, of course, not the only solution that can be generated theoretically.

[6] Charles P. Kindleberger, The World In Depression, 1929-1939. Berkeley: University of California Press, 1973. p. 247.

[7] Hegemonic stability theory identified a number of long term problems including but not limited to differential growth rates; the increasing costs to and relative decline of hegemons, the difficulty of replacing one hegemon with another peaceably.

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central problem of IPE, since the ability to create money is held almost entirely by states as a sovereign prerogative. If exchange rate stability is roughly a collective good, it is still the case that any particular monetary regime imposes differential costs and benefits which means states have incentives to try to skew the system and their own position in it to serve parochial interests. Many of those interests are tied to business cycles in the domestic political economy. For example, excessive government spending on deficit that a state undertakes during downturns creates incentives to inflate away some of the debt that accumulates. Devaluation of the national currency is a classic individual state strategy for boosting international competitiveness and saving jobs at home – most tempting during periods of high unemployment. Even the basic notion of an "optimal currency area" depends heavily on the geographic and sectoral shape of economic shocks – disruptions that (as I explain later) play an important role in business cycles.

Central problems in North-South relations and development are also tied to business cycles. In the modern liberalizing world economy, development in the South depends heavily on sustained global growth that can be accessed through trade and open markets, stable financial flows for investment, diffusion of appropriate technologies, and protection of the environment. Business cycles complicate each of these. Direct official transfers in the form of state and multilateral aid come under pressure when economic activity slows. Downturns in the North breed protectionism that can cut off export markets for producers in the South. If interest rates rise and/or exchange rates shift so as to make debt service more burdensome at the same time, debt crises, defaults, and/or massive devaluations with their attendant political risks for Southern regimes (and problems of cooperation both between creditors and debtors, and among the members of each group) follow. Finance also trends to track cycles, with abundant FDI and portfolio investment that is available during upswings often suffering retrenchment and repatriation during downturns.

International issues of unemployment are also shaped by business cycles. As "adjustment unemployment" in a booming and fundamentally transforming world economy digs deeper into the domestic political agenda of the major northern states, the question facing political leaders becomes more concrete than just location of

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production in a world economy. It is about locating a certain number of jobs, and jobs of a certain kind and quality, within national borders. New problems of cooperation arise as the northern states struggle to deal with the employment consequences of exploding low-cost production in the developing world. Certainly there is potential for beggar-thy-neighbor dynamics in allocating adjustment unemployment; what the French call "social dumping"; and other non-cooperative policies (in exchange rates, most obviously) aimed at keeping jobs onshore. Business cycles will place enormous strain on any international regime arrangements put together to avoid such policies.

These are a few examples of how business cycles play an important but often implicit role in central problems of IPE. Probably we have been comfortable in leaving this implicit, because it never before made much sense to ask what would look different in the absence of something that we thought would be a constant. The next sections of the paper argue that business cycles may not, however, be as important in the future as they were in the past.

Explaining the Business Cycle

There is no consensual body of theory that clearly explains why business cycles happen. Business cycle theories have developed mostly through empirical investigation and inductive reasoning, not deduction. This yields strengths and weaknesses. The major strength is that business cycle theories address concrete problems and observations from the real world. The major weakness is the possibility that any particular theoretical explanation might be overly specific to the observations that prompted it. And in what might be either a strength or a weakness, there exist in the literature a large number of different stories about why business cycles happen. I try here to develop a loose typology of those stories, emphasizing for each what are the major driving forces that set off and sustain business cycles.

In a 1950 review, Achinstein distinguished three main types of proposed explanations for cycles: physical, psychological, and

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cultural.[8] Theories of physical processes traditionally emphasized fluctuating agricultural production, which was in turn driven by changes in the weather.[9] Psychological theories emphasize recurrent waves of optimism and pessimism in the minds of consumers and business decision makers. Cultural arguments have as their major driving force the institutional patterns within which production is organized, income distributed, capital accumulated, and goods exchanged. Achinstein argued that most business cycle theory was actually cultural. Of course, psychological processes in economics as elsewhere are deeply embedded in social institutions; so it is hard to imagine studying optimism and pessimism in consumption and investment behavior without putting cultural institutions at the center of that study. Physical processes in some sense could stand on their own. But unless we are looking at something like a world-wide famine caused by global climate change of magnitude, the consequences for economic activity of a physical change are unclear until we know the institutional structure on which physical processes impact. Schumpeter was perhaps the most prominent spokesman for the view that the study of business cycles was, in fact, the study of capitalist institutions.[10]

Modern business cycle theory makes analytic sense of this by dividing its stories about business cycles into *exogenous shocks* and *endogenous dynamics*. There is an exogenous shock that hits the economy. Then there are endogenous dynamics that drive a cycle. Another way to describe this, is a series of stories about inherently cyclical responses to exogenous shocks.[11] Current mainstream arguments differ from each other on two grounds. First, from where does the exogenous shock arise? Second, what are the endogenous cyclical dynamics that turn the shock into a business cycle? There is more disagreement about the first point than about the second. I

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[8] Asher Achinstein, Introduction to Business Cycles (New York: Thomas Y. Crowell, 1950).

[9] Ibid, p. 5.

[10] Joseph A. Schumpeter, Business Cycles; a Theoretical, Historical, and Statistical Analysis of the Capitalist Process. New York: McGraw-Hill, 1939.

[11] Distinguishing endogenous from exogenous things here is an analytic device that makes it easier to construct an argument. Even if "exogenous" shocks were shown to be the consequence of some endogenous process, that would not change the argument fundamentally nor damage its analytical utility.

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present a typology of major arguments here along with brief explanation and selected criticism. My purpose is not to establish or dismiss these arguments as *theories*. The debate between them may not be resolved anytime soon. I take these arguments as serious*claims about critical driving forces* that lie – probably in reality, in some combination – behind business cycles.

Exogenous Shocks: *Demand Side Arguments*

Two kinds of arguments see shocks coming principally from the demand side. The first, *monetarist* explanations, stress as the critical driving force "errors" in monetary policy that lead to instability in expectations via inappropriate rates of change in the money supply. This can set off a number of endogenous cyclical dynamics. Price information can be confused. Businesses can mistake a move in the price level (which is actually here about restoring equilibrium between supply and demand for *nominal* money) for a *real* change in demand for goods and services – with impacts on investment decisions. Banks can over- or under- lend. There are problems with these arguments, not least of which is the difficulty researchers have in finding empirical evidence to support them. On deductive grounds, economists who accept the notion of rational expectations equilibrium point out that only unanticipated changes in money supply could have these effects. The evidence, however, is not compelling that there is any substantial difference in the cyclical consequences between anticipated and unanticipated changes in money supply.[12]

Keynesian explanations provide a second plausible demand side argument about exogenous shocks. (Keynesian economics is also central to much of the endogenous dynamics of cycles, which I discuss later).[13] Here, the shock comes from instability of private spending and even more so, from investment. In this scheme, investment changes the level of income and in turn governs savings. With S=I,

[12] A classic statement is Ralph G. Hawtrey, Currency and Credit (NY: Longmans, 1931). Milton Friedman is a well-known modern proponents of this view. For evidence on the impact of rational expectations see Victor Zarnowitz, "What is a Business Cycle?", NBER Working Paper 3863 (Cambridge, MA: NBER, October 1991), p. 47.

[13] Keynes himself did not pay much specific attention to cycles, but did emphasize the general idea that exogenous shocks get propagated through endogenous processes into large cyclical movements.

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the main problem is to understand the forces that influence decisions (mostly private ones) to consume or to invest. Decisions to consume depend on the marginal propensity to consume, which is really a psychological assumption about non-linearities in the relationship between income levels, rate of change, and spending. The more important driver is the marginal efficiency of capital, which determines the level of investment by business. The marginal efficiency of capital reflects the expected return on money spent on additional capital formation. Decisions to invest depend, basically, on the marginal efficiency of capital versus interest rates. That comparison has to be made in the context of volatile and uncertain expectations – about demand, technology, productivity, future prices, and so on. Those expectations are erratic. Over-optimism and over-pessimism drive fluctuations in capital investment, with multiplier effects in either direction.

Supply Side Arguments

The simplest supply side arguments are basically extensions of Achinstein's physical processes story. Things happen that change the price of important inputs. If these things happen rapidly and unexpectedly, the result can be the exogenous shock that sets off a cycle. Sunspot activity leads to climate change, and the price of food skyrockets. Or (more realistically) a group of oil exporting nations establish a (temporarily successful) cartel that multiplies the price of oil. It's not that politics or institutions are absent from this kind of shock, of course. But the emphasis is on a price change set off by primarily physical processes, affecting a central economic input significantly enough to set off endogenous cyclical dynamics.

The more interesting supply side arguments fall roughly into a category known as "*real business cycle theory*". The common theme here is productivity shock, usually brought on by a large and sudden change in technology that alters substantially the costs of production or makes possible the production of entirely new things. Productivity shocks throw a wrench into even a dynamic equilibrium, by changing the basic contours of supply (and usually – although less directly – demand as well). New technologies make necessary decisions about new capital goods, which take time to produce and then to incorporate into production processes that in turn feed demand. The long gestation period involving capital goods means that output

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movements (or lack thereof) are persistent and can't respond smoothly to changes in demand. Resulting price fluctuations on the supply side set off the endogenous dynamics that create business cycles.

I have indulged in considerable oversimplification here, as well as omitting discussion of a few other possible sources of shock – notably, electoral rhythms that certainly influence the way governments conduct fiscal and monetary policy. What I hope I have accomplished, is to highlight the essential driving forces that major arguments point to as critical exogenous shocks.

Endogenous dynamics drive the cycle in response to shocks. Stories about how these dynamics evolve differ in chronology (what comes first, what comes later, what variables lag the cycle and what variables precede it) as well as in emphasis (what is most important). Part of the reason for that lies in different theoretical predispositions. Part lies in empirical differences among real world cycles, each of which tends to yield its own set of stylized facts to which an explanatory story has to bear some resemblance.

I summarize here major common elements among these stories. They share the notion that uncertainty in business planning leads to mistakes that propagate through the economy. Planning uncertainty, in turn, results from the competitive structure of the economy and the time lag between perceived demand and production. Since people know this is happening, psychology comes into play as business planners look not only to the external world with its noisy signals about prices and demand but also to each other for signals of optimism, pessimism, and clues on how to interpret what data they have. Business fixed investment fluctuates. Inventories expand and contract in ways that don't reflect closely changes in demand. The costs of carrying inventories depend in part on interest rates, which may also be changing. Since expectations of the marginal efficiency of capital are themselves uncertain even before the comparison to expectations about interest rates, there is plenty of room for error. Prices will shift to adjust but wages, which are sticky, less so, causing cyclical unemployment. As multiplier and accelerator effects work their way through the economy, further demand shifts complicate again calculations about inventories and the marginal efficiency of capital. Profits fluctuate, and so do future expectations of profits. Investment calculations change. And so on and so forth.

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This last paragraph would best be read not as a series of linear sentences but as a circle. Where you start on the circle depends on your theoretical predisposition, as well as what you believe are the most important sources of exogenous shock. Stylized stories about particular cycles usually work from a starting point, through a series of these changes, to show that many arrows point in the same direction and reinforce each other. Positive feedback (at least at the beginning of a cycle) leads here to recession, or here to recovery. A few arrows point in the opposite direction; these are the countercyclical forces that will pull the economy out of the trough or stall it at its height. Recession begets revival; and revival, recession.

In sum, business cycle "theory" – like the reality it tries to explain – is a complicated thing. Rather than taking theory as a set of falsifiable propositions that specify causes and their relative weights, I have treated these arguments as claims about driving forces that lie behind cyclical movements in economic activity. For my purposes, these claims do not compete one with the other. They are complementary and it would be perfectly fine if all were operating as partial causes.

The next section makes two points on this score. First, the exogenous shocks that business cycle theories identify are diminishing in the modern economy (though not going away entirely). Second, the cyclical dynamics that respond to shocks are increasingly damped. The argument is that modern economies operate in ways that reduce the propensity to shock and cycle.

The Future of the Business Cycle

Popular media described the 89-95 recession/recovery cycle in many OECD economies as "different", "peculiar", or "strange". Because there are no precise definitions or standard measurement criteria for business cycles, the question "was that cycle *different*" really begs the question "are they *all* different".[14] They probably are. Still, aggregate statistics on production, employment, real income, sales, prices, hours worked per week, inventory sales ratios, etc. do reveal cyclical patterns as well as some interesting changes in

[14] See for example Michael Ulan, "Is the Current Business Cycle Different? Does How We Measure Matter?" Business Economics 29. April, 1994. pp. 41-47.

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cycling in the American economy. Victor Zarnowitz lists several important trends:[15]

- The expansion phases of cycles have gotten longer on average as well as more variable in length, although that variation is almost entirely on the upside. Peacetime expansions before 1945 lasted between 10 and 50 months; after 1945 between 12 and 92 months.

- Contractions have gotten shorter and more uniform in length.

- Contractions have gotten milder. Even the most severe post war recessions, the 73-75 period and the 81-82 Reagan recession were much milder than the two interwar downturns and of course the great depression.

Zarnowitz's work attracts discussion. Christina Romer questions the basic finding. She argues that traditional estimates on pre-World War I data have a built in bias toward volatility (since they rely heavily on commodities) and that when this is taken into account the trends Zarnowitz finds are not statistically significant.[16] John Taylor (along with most other macroeconomists) accepts that fluctuations probably have become less severe, but he finds at the same time that wages and prices are more rigid in the post world war II period (at least until 1983).[17] It seems that all things equal, wage and price rigidity should *exacerbate* fluctuations by making it harder for demand and supply to adjust to shocks. Taylor's view is that counter-cyclical government policy compensates for rigidities (and might even partially explain them, since the expectation that governments will act to damp cycles reduces incentives of private actors to challenge rigidities connected to long union based work contracts, large business enterprises, etc). DeLong and Summers

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[15] Zarnowitz, "What is a Business Cycle?"

[16] Christina Romer, "The Pre-War Business Cycle Reconsidered: New Estimates of GNP, 1869-1908," Journal of Political Economy 97. 1989. pp. 1-36. An opposing view is N. Balke and R. Gordon, "The Estimation of Pre-War GNP: Methodology and Evidence," Ibid pp. 39-92.

[17] John B. Taylor, "Improvements in Macroeconomic Stability: The Role of Wages and Prices", in Robert J. Gordon, ed., The American Business Cycle: Continuity and Change, Chicago: University of Chicago Press, 1986.

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propose that rigidities could actually have been a *stabilizing* factor during this period.[18] The intuition here is that rigidities under some conditions can counter deflationary pressures and keep real interest rates steady. For example, long term labor contracts might slow the response of employment to fluctuations in demand and stabilize workers' disposable income.

Would it then be right to suspect that a *less* rigid economy (like the picture I paint in the next section) will be *more* volatile to fluctuations, even with countercyclical stabilizers in place? Probably not, since the relationship between rigidities and fluctuations is almost certainly not monotonic. In an economy with high transaction costs and rampant inefficiencies, rigidities might very well have a stabilizing effect. But in an economy where factors (including labor) can move and re-deploy at lower cost, and where a well-developed private credit system smoothes out consumption and investment, removing rigidities would probably have the overall effect of smoothing adjustment to demand or supply side shocks – thus reducing macroeconomic fluctuations. Each of these arguments almost certainly picks up part of what explains apparent dampening.

The most recent American business cycle is largely consistent with these trends. The 90-91 recession was unusually shallow and brief, and was followed by a long gradual expansion phase. Real output declined a total of only 1.6% and only for only two quarters – the fourth quarter of 1990 and the first quarter of 1991.[19] The fall in output was so mild that *The Economist* in 1992 declared that the experience barely qualified for the label recession.[20] Changes in employment were similarly mild. Unemployment – which topped 11% in 81-82 – reached a little over 7% in 90-91. On the upside, a shallow recession gave way to a shallow recovery – particularly in employment, earning the nickname of "jobless recovery". In 50 months after the trough of the recession the US economy generated about 8.1 jobs (full and part time). After the '75 and '82

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[18] J. Bradford DeLong and Lawrence H. Summers, "The Changing Cyclical Variability of Economic Activity in the United States", in Gordon, ed., The American Business Cycle.

[19] According to NBER, the recession started in July 1990 and bottomed out in March 1991. For comparison, output shrunk between 3 and 4% in the previous two recessions, and about 30% in the great depression.

[20] "Recession or Doom?" Economist, October 24, 1992. p. 13.

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recessions the numbers were 13.5 million and 12.1 million jobs respectively.

Recession (Approx)	*Change in Output*	*Unemployment*
73-75	-4.1%	9%
81-82	-2.8%	11%
90-91	-1.6%	7%

(Source: "Free fall?" The Economist, January 4, 1992. p. 9)

The recovery phase of this cycle (arguably still going on as I write this) has been peculiar in other respects. Most interesting is the lack of inflationary pressures. Two standard driving forces of inflation – low unemployment, and high capacity utilization – do not seem to be operating "normally". Although economists disagree about the precise number, the consensus has been that when unemployment falls below some particular threshold the labor market becomes sufficiently tight that workers can demand and receive higher pay – the classic story of wage push inflation. The Fed reportedly uses 6.2% as a conservative estimate of that threshold.[21] Unemployment drifted downwards from 6.4% in December of 1993 to 5.4% in December of 1994 and remained as low as 5.6% in January 1996, falling even further through the spring to around 5.2%. But there is no evidence of substantial wage push inflationary pressure. Average hourly earnings in America rose 3% in 1993 which was 0% in real terms; and 2.9% in 1994 which was about .4% in real terms.[22]

Capacity utilization is also supposed to drive inflation when it reaches 81 to 82 %.[23] After recovering from below 78% in 1991, capacity utilization hit 81% in the middle of 1992 and has not fallen below that level since. In August 1994 capacity utilization for US

[21] Louis Uchitelle, "Growth of Jobs May Be Casualty in Inflation Fight," New York Times 16 Nov 1994 p. 6.
[22] University of Michigan gopher, Department of Commerce Statistics.
[23] As with unemployment, there is disagreement about the precise numbers. 81 to 82 % are conservative estimates, reportedly used by Fed economists. Financial Times 13 July 1995 p. 11.

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factories, mines, and utilities hit a local maximum at 84.7%; in the automobile industry the number was more than 87%. Three months later, overall utilization peaked at over 85%. The slowdown of spring 1995 brought the level down only to about 83.7%, still significantly above the supposed threshold for inflationary pressures.[24] And although producer prices did in 1994 reflect some upward pressure (presumably from capacity utilization at least in part), consumer price inflation has steadied at around 3% and expectations of future inflation as reflected in the long bond market have been similarly steady.

These peculiarities have prompted occasional speculation in the popular and business press that the business cycle has somehow died out.[25] A more modest argument is that the current cycle reveals some significant changes in how modern economies operate, and that these changes will tend to dampen out business cycles and render them in the future less prevalent, less severe, and less significant than in the past.

I am going to defend the plausibility of that argument in two steps. First, I present a modern economic fairy tale. This is a fictional story about a business cycle that didn't happen. The story captures and integrates the four schools of thought concerning the driving forces of business cycles that I outlined. The story also highlights in a narrative fashion what is different in modern economies, that would counteract the driving forces.

Like all fairy tales, this one contains important lessons that can be extracted and looked at separately. In the second step I extract six things about the world economy that I believe contribute to muting of the business cycle, and I present arguments and evidence that each is indeed having that effect. The six are: "globalization" of processes of adding value, changes in finance, changes in the nature of employment, government policy, emerging markets, and information technology.

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[24] New York Times 17 Sept 1994 p. 1 (Louis Uchitelle, "With Factories Near Their Limits, Inflation Fears are Rising Again) and 16 Nov. 1994 p. 6 (Robert D. Hershey Jr., "US Industry Had A Surge in October").

[25] For example, see The Sommers Letter, June 29 1993, The Conference Board, New York, p. 2.

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The Business Cycle That Didn't Happen

It had been a robust recovery and now it was reaching its supposed end. The problem was, businesses had not expected it to be quite so robust. Those were sensible expectations. The preceding slowdown had been painfully drawn out, and the recovery, at least when it began, was halting and weak. Fearing overcapacity, businesswomen had held back on investment and had been slow to hire permanent employees. So when the expansion picked up steam and kept rolling right along, they soon found themselves struggling to meet orders.

Undercapacity turned out to be the real challenge. In effect, business had vastly underestimated the marginal efficiency of capital in this recovery. Demand, far from being sluggish, had exploded in the form of robust export markets in the developing world. Billions of new consumers in Asia and elsewhere took an increasing percentage of developed country exports and kept factories in America running hard to keep up.

Many economists said that these mistakes would cut off the expansion. With inventories cut to the bone, capacity utilization, now reaching near to 87%, could hardly go up further without sparking increased prices. 5.5% unemployment meant that any new demand for workers would bring wage pressure. Inflation was surely on the horizon.

A sharp rise in commodity prices over several months seemed to confirm these predictions, and struck fear into the collective heart of the Federal Reserve. In a dramatic move, the Fed boosted the discount and the Federal funds rate 100 basis points each. The reaction on Wall Street was glum. Surely this was an over-reaction, too much too fast for this economy. Traders expected a predictable sequence of events: firms paying more to carry inventory and service debt; investment declining; consumers postponing purchases so they could pay off existing debt; falling demand; weak corporate profits; worker lay-offs; and so on.

Many of these predictions turned out to be mistaken. The Fed's move did increase the costs of borrowing for business, but not to the extent that Wall Street anticipated. Corporate finance was much more sophisticated and diversified now, and many firms were utilizing complex financial instruments that weren't so closely tied to the prime rate. Deregulation and information technology meant that not only

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large multinationals, but a surprising number of small and medium sized businesses as well, had access to a global pool of capital. Markets in Singapore or Taiwan, increasingly transparent and competitive with London and New York, were ready and able to finance projects in America.

Consumer spending did decline somewhat, particularly among Americans unlucky enough to hold variable rate mortgages and credit card debt. But for many businesses, those Americans had become a significantly smaller part of their overall demand structure. It wasn't only large multinationals that serviced the global economy. Low transport costs and the declining costs of information made it possible for medium sized and increasingly even small firms to find niches in foreign markets.

Surely American firms cut back on inventory. But as many of the input items on their shelves were imports anyway, the cuts did not deeply affect production in America. The trade balance a few months later showed exports up and imports down, with domestic production in most sectors holding nearly steady.

The pressure was on to cut costs. But with production still robust, firms found it hard to lay off workers. Those who were laid off were disproportionately temporary workers, many of whom found new temporary positions in sectors that were doing well. Unemployment on aggregate was up, but not nearly so much as had been feared. In fact, government deficits barely suffered because there was no marked increase in welfare or unemployment insurance payouts. Long term interest rates settled back to near where they had been before the Fed's move.

Of course, there were some serious shocks in the price of inputs. This was made worse for American mass commercial bakeries, in particular, by a spate of severe thunderstorms which destroyed large proportions of the cane harvest in the Caribbean and boosted the price of raw sugar by 30%. Market analysts predicted a disastrous 50 cent per package rise in cost of cookies.

But the bakeries were protected. Low tariffs and decreasing transportation costs along with the growth of spot markets made it feasible to seek and find quickly other sources of sugar. Futures contracts for raw cane backed up by exchange rate derivatives to protect against currency fluctuations were a further hedge. Engineers pushed production technologies to the limit and found that with

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newly efficient ovens and rapid cooling systems coming on line, they could boost efficiency and make up for nearly a third of the sugar price increase. Inventories were cut to a bare bone, but this could now be done without risking reputations for supplier reliability, since information technologies made it possible to assess supply and demand in diverse market segments in near real-time. Some temporary workers were sent back to Manpower, but overall employment in the industry barely budged. Profits declined marginally, but in response to articles in the business press that applauded the way the industry had handled a prospective crisis, stock prices actually increased. Ambitious investment plans by some industry leaders to open new cookie factories in Beijing moved forward.

The economic pundits soon went back to worrying about inflation from wage-push and capacity-utilization. But the meaning of "full capacity" had changed in an increasingly globalized production system linked up by low transport and low information costs. American firms that had trouble filling orders from their factories in Kansas were able to locate substitutable capacity in factories in Malaysia and India. In some cases, they bought output from those factories. In others, they leased capacity. In fact these were the best options, because if the American firm had tried to raise its prices instead, then the Malaysian and Indian factories would have eventually found and serviced the buyer on their own. In a globalized production system, there was always slack capacity somewhere and the problem was simply to find it and make it work.

"Full employment" also meant something different. In March 1994 Martin Feldstein (head of NBER) had said of 6.5% unemployment that "we are essentially at full employment today."[26] But wage-push remained weak far below that number. Unions that had suffered the politics of the Reagan administration in the 1980s suffered even more the economics of the 1990s. Low wage unskilled workers in the West faced new technologies and new competitors in Indonesia and China. While productivity was still much higher in the OECD than in most developing countries, it was not so much higher that factories faced with wage demands in labor intensive industries

[26] "Inflation Specter," New York Times March 28 1994 p. C1.

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would not choose to move. The bottom line was a fall in demand for unskilled workers in the developing world – leading to declining real wages in America and Britain, or rising unemployment in countries where unions and welfare state provisions had put a floor under wages. In both cases, higher wages go to skilled workers with higher productivity – which is not wage push inflation. And in all labor segments, the increasing use of temporary workers puts firms in a position where they were essentially managing a portfolio of labor more so than a permanent work force. Portfolios are flexible; they can be priced and repriced, hedged and insured, adjusted through selling and buying on spot markets, and so on. Wage push inflation at 6.5% unemployment seemed a thing of the past.

The rise of Asia had important supply side effects in the developed world. With (relatively) open trade, lower wages and costs in the developing world and the strong energy of economic growth there brought new competition to the developed world – first in low technology and later in middle technology industries. Prices were pushed downwards, stimulating the search for efficiency in production and use of resources. Cost cutting hurts, but there are compensatory advantages, such as improved terms of trade for rich country consumers who enjoy lower prices on imported goods; and financial diversification for investors who seek (and find) through increasingly globalized capital markets higher returns in emerging economies.

The push "upmarket" for developed countries spawned new fears of an "info-tech" recession brought on by the technology shock of computerization. Would unforeseen productivity fluctuations eliminate entire classes of jobs, create a permanent underclass of information know-nots, and "hollow out" the real economy of the West leaving massive unemployment in its wake? Of course, information technology did displace workers – but not on the scale that pessimists had feared. In the manufacturing sector, at least, many of these workers would have lost jobs anyway through competition from NEC imports.[27] But the manufacturing sector had become a much smaller segment of the workforce, more important symbolically than in the real economy. Meanwhile,

[27] NEC is an acronym for "Newly Exporting Countries" -- China, Indonesia, Thailand, Malaysia, perhaps Vietnam.

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computers created new classes of employment – higher wage, skilled service employment open to more educated and flexible workers of the "next generation".

Demography and labor market flexibility made the adjustment process less onerous than it was expected to be. Slow population growth in the West meant it simply wasn't necessary to provide quite as many jobs. Rigid labor markets (even in Japan and Germany) gradually loosened up. In many industries, info-tech transformed labor into nearly a just-in-time input. But this suited fine the increasing number of temporary workers who learned to sell their capabilities on something like a spot market rather than through long term contracts. Once the US passed a comprehensive health care bill, the negative stigma attached to temporary employment was replaced by a certain kind of cachet. This was the permanentization of temporary work, and Americans got used to it (and began to value the freedom and flexibility it entailed) faster than anyone had believed they could. The permeation of info-tech through the economy also forced Americans to take much more seriously education and education reform. From elementary school through workforce training and into "adult" education, the system was being transformed gradually toward the ideal of a seamless web where the norm was that "learning" would be a lifetime profession for everyone. Even marginal improvements in this direction proved a great boost to the workforce and the companies that they moved between.

Many of those companies found the world they were selling into changing just as quickly as the world inside their walls. Successful firms were innovating at an unprecedented rate. Service firms found that they could sell a wide range of services on world markets. Not everyone in the world needed state of the art sophistication; good old insurance and lending services along with simple computer technology had enormous markets in the developing world and Asia. (Coincidentally, this buffered the jobs of at least some "obsolete" service workers as well) Profits from these ventures helped to amortize the enormous installed capital base of late 1980s technology in the West, and financed the development of new services whose markets, at least initially, were in the West as well.

By the late 1990s worries about an info-tech "overheating" had largely replaced concern about recession. But this too would turn out to be a chimera. The info-tech phase of the industrial revolution

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would no sooner run out of inputs than out of customers. Increasingly sophisticated and deep markets traded things that *could* run out (or at least run into shortages) – so price swings in commodities, land, and other real "assets" were damped and the impact of those price swings mediated by complex hedging and trading of longer term risks and expectations. When the statistical measures collected by governments caught up with what was happening in the real economy, they would show that a moderate rate of growth for the world economy but more interestingly an increasingly steady growth rate. The business cycle was damped.

Six Things That Are Different

The modern international political economy is changing in ways that could reduce the overall propensity to cycle as well as the depth of cycles in the developed world. I extract here six major differences – a selective not comprehensive list.

Changes in the Nature of Employment

Two major changes in the nature of employment contribute to the dampening phenomenon: the shift from manufacturing jobs to service jobs; and the growth of temporary and "portfolio" employment relative to "career" employment.

There has been an enormous increase in employment in the service sectors of modern economies. In 1950, services employed about half of US workers. In 1992 services accounted for almost 80% of American jobs.[28] The US numbers are the most dramatic among the OECD countries, but by no means out of line with trends in other advanced countries. This matters because – while some service industries remain subject to cyclical swings in employment – service employment generally is less cyclical than employment in manufacturing.[29]

There are two principal reasons for this. First, services are less vulnerable to large swings in inventories. The sector is composed of

[28] See Jaewoo Lee, "Do Services Temper Business Cycles?", UC Irvine Dept of Economics Working Paper 95-96-3, February 1996.

[29] Andrew Wyckoff, "The Growing Strength of Services," OECD Observer No. 200, June 1996.

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relatively intangible goods (stocks and bonds, knowledge); or the rental of equipment (BlockBuster Video); or the delivery of a function in real time (haircuts or medical care). It is hard to build up or run down stocks of these. Second, the demand for many services (particularly real time delivery) remains relatively constant through downturns in economic activity. Government services rarely decline in a recession; they are almost always countercyclical.. Restaurants suffer during recessions, but not nearly so much as makers of automobiles. In the most recent US economic downturn, manufacturing output dropped about 3.4% while the output of services did not decline at all. Even in the manufacturing "powerhouses" the difference was clear: Japanese manufacturing output dropped 13.5% in the last downturn, while services dropped only 2%; for Germany the numbers were 11% and .2% respectively.[30]

The increase in service employment is also one factor behind the general decline in union strength. Strong unions are typically associated with manufacturing and industry: steel, rubber, autos, textiles, and the like. Union membership peaked in the United States in 1953 at 34.1% of the labor force; in 1992 that figure had fallen to 16%.[31] Finland and Sweden aside, trade union membership fell in all OECD countries during the 1980s by an average of 6.4%.[32] Weaker unions should signal diminished pressures for wage push inflation. One measure of that, the prevalence of strikes among workers, shows the trend. Almost all the advanced industrial countries lost fewer working days per 1000 employees to strikes in 1989-93 than they did in the previous four years.[33] US strikes fell in 1995 to a historic 50 year low.[34] Declining union power has contributed to the development of increasingly "flexible" labor markets, extending to downwardly flexible wages in some OECD countries and most notably in the US.

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[30] Statistics from Economist May 20 1995, p. 106.
[31] Nick Salvatore, "The Decline of Labor." Dissent, Winter, 1992. (non-agricultural workers)
[32] Economist 23 July 1994 p. 102.
[33] Economist 21 January 1995, p. 106.
[34] "Strikes Decrease to a Fifty Year Low," New York Times 29 Jan. 1996 p. A1.

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Labor market flexibility has also gained from a secular shift away from the old paradigm of career or lifetime employment, towards the fastest growing category of worker in the US - the temporary worker. "Temps" are typically employed through an agency, acting essentially as a labor broker, that fills an assignment with a worker for a given period of time which is often the length of a specific project. In principle, the growth of temporary employment mirrors the development of spot markets and just-in-time management of other factors of production. And temporary employment is growing quickly. While the Fortune 500 companies have reduced their regular full time labor force by more than 30% in the last 15 years, the number of temps in the US has grown nearly 19% in the last three years – and is projected to increase another 60% over the next decade.[35] Growth has been most rapid in technical and professional fields (including not-so low wage ones like accounting, computer services, and medicine) where "permanent" status as a temporary worker is increasingly becoming a respectable career path. The effect in the short to medium term should be a more efficient labor market overall. In the longer term, labor analysts foresee the development of something like a "portfolio career" in which workers mix assignments and "jobs" that put their skills and talents to use in a variety of ways. Risk is being shared out among labor as well as capital. The result should be more flexibility in cost, production, and output – both size and kind.

Information Technology

Rapid innovations in information technologies may work in several different ways to dampen the business cycle. One important application of IT is in the management of inventories. Consider as an example Caterpillar Corporation's "Antares" parts system which manages more than half a million part numbers for the estimated 1.3 million pieces of Caterpillar heavy equipment that exist worldwide. Antares performs about 25,000 parts searches per day by browsing through the inventories of 150 Caterpillar dealers and 23 distribution

[35] Statistics from US Labor Department, quoted in New York Times 20 May 1996, p. C1, 10. See also San Francisco Business Times, February 17, 1995.

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centers.[36] The major advantage to Caterpillar is speedy availability of parts and, even more importantly, much slimmer inventories.

There is evidence that on aggregate inventories are being managed more efficiently. In America and Britain, the ratio of stocks to sales in manufacturing fell by about 17% during the 1980s. US ratios have been reduced an additional 8% in the first half of the 1990s.[37] In the most recent cycle inventories barely budged: the ratio of sales to inventories rose by only 5% in the mid-1990 downturn (compared to 15% during the 81-82 recession) and increased by even less than that in the spring 95 downturn.[38] The same is true on the upswing: companies are resisting the temptation to build inventory in anticipation of unmet demand. In 1994 inventory expansion added just about 0.7% to GDP growth. And despite shortfalls in production during the 94 expansion at some large consumer durables makers like GM and General Electric appliances, the anecdotal evidence strongly suggests that inventory lean-ness is here to stay. [39]

It also contributes more directly to efficiency in production and marketing. Though the effects are often hard to measure precisely, the use of CAD/CAM, enterprise resource planning software, production scheduling systems, EDI (Electronic data interchange) networks, etc. has probably contributed significantly to productivity and has almost certainly helped industry shorten time-to-market through improved management of the supply chain. In some industries the term "supply chain" itself is becoming obsolete as information systems link suppliers to factories to customers, and run in both directions. In 1995 US manufacturers probably spent close to $4 billion on such integrated systems, a 30% increase over the prior year.[40] When customers work together with suppliers to design products, manage inventory, modify requirements, and bring innovation to market, the disconnect between demand and supply is

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[36] Doug Bartholomew. "Blue Collar Computing." Information Week, June 19, 1995, p. 34.
[37] Economist, 5 August 1989, p. 63; "The Economic Recovery May Not Be Robust But It's Certainly Real." Chicago Tribune August 14, 1992, p. 17.
[38] Business Week 4 April 1994, p. 57; American Express Bank, Economics for Investment, July 1995, p.12.
[39] Ibid.
[40] Bartholomew. "Blue Collar Computing."

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reduced. As information about markets and buyers improves, the need to hedge against uncertain developments in demand diminishes apace. The end result is an improvement in supply-demand coordination in near-real time, and a dampening of business cycle pressures.

Globalization of Value-Added Processes

The on-going globalization of value-added processes should also contribute to dampening of the business cycle. Clearly, we do not now live in a global or borderless economy. But it is also clear that production activities, services, and finance are spreading out spatially around the world. The increasing ease with which production and other value-added processes move across national borders will have a number of favorable effects on business cycles, primarily by reducing the sensitivity of economic activity to monetary, capacity, or demand conditions in any single country.

Albeit in fits and starts, the post War world has seen a massive overall reduction in trade barriers. Every industrialized country in the world (with the sole exception of Japan) today exports a higher percentage of its GDP than in 1960. The growth of merchandise trade is legion. A few statistics just to remind: world merchandise exports have grown every year since 1976 with the sole exception of 1982. Since 1985, US exports have more than doubled, Britain's exports have increased by 50%, Japan's imports by nearly 100%.[41] The growth in sales by foreign affiliates of multinational firms is harder to measure, but probably now exceeds world trade.[42] For an increasing number of companies and not just the big multinationals, "demand" is becoming more a global than a national concept. The same is happening with supply, particularly as firms in many industries "delaminate" and link up with supplier networks which are themselves increasingly international. Having multiple suppliers in different countries and different regions of the world insulates firms from labor movements, capacity blockages, and government policy in any one place. For example, when capacity

[41] Economist 10 June 1995 p. 97.
[42] "Global Economic Prospects and the Developing Countries, 1995" World Bank, Bank News Release No. 95/S74, 18 April, 1995.

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utilization peaks in one country, the problem is to find slack capacity somewhere else in the world and use it – whether through supplier arrangements, subcontracting, leasing, or something else. Gillette is often cited as a case-study in this kind of arrangement, as it shifts production from factory to factory around the world to cope with fluctuations in demand as well as changes in input prices.[43] It is not so easy to juggle and fine-tune a "manufacturing portfolio" as it is a financial portfolio, but the two are becoming somewhat more like each other than they are different.

The shift towards services reinforces this trend. Just as services (which are inherently less cyclical than is manufacturing) are becoming a greater proportion of value-added processes, trade in services is increasing – recently, at a rate far exceeding trade in manufactures. Although it was starting from a much lower base, world trade in services grew 7.7% annually on average between 1980 and 1993, while merchandise trade grew 4.9% on average.[44] So-called "invisible exports" (which include services, non-commercial transfers, and income from overseas assets) reached $2.4 trillion in 1993 for the world; merchandise trade that year was $3.6 trillion. For the US, which leads the world in invisible exports (and accumulates the world's largest invisible trade surplus), invisible exports may now account for as much as 10% of GDP.[45] Maturation and deepening of financial markets, further (even patchy) progress in the WTO on services, sweeping privatization in telecommunications, and so on will likely accelerate these trends in the near future, which will future diminish the driving forces for cycling in the advanced industrial countries.

Finance

Developments in finance, in particular increasingly sophisticated products traded in deepening markets, should contribute to dampening of the business cycle. Modern finance is increasingly efficient at linking capital to production, spreading risk, and providing

[43] Economist 24 June 1995.
[44] "Global Economic Prospects and the Developing Countries, 1995," World Bank, Bank News Release No. 95/S74, 18 April 1995.
[45] Economist 16 July 1994 p. 97.

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investors and producers new ways to manage uncertainty and smooth out fluctuations.

Finance during the 1980s went both high-tech and global. The growth of financial markets in the last decade has been impressive in absolute terms, and relative to the size of real economies. As an example, many Latin American countries began the 80s with stock market capitalizations around 5-10% of their GNP. Now the numbers range between 50 and 100%. Between 1988 and 1994 the total market capitalization of 21 countries in the IFC Composite Emerging Market Index jumped from $352 bn. to $1.1 tn. At least five developing countries had in 1994 stockmarkets with capitalizations worth more than national income.[46] Developed countries' market capitalization increased somewhat less, but of course they had larger markets to start (aggregate numbers are also depressed specifically by the recent weakness of the Japanese market).[47]

The growth of securitization, "non-banks", and alternative markets as well as mutual funds and similar products has been phenomenal – particularly, but not only in the US. Concerns about derivatives reflect this enormous growth. In developed countries, trading in over-the-counter derivatives (including but not limited to currency and interest-rate swaps) jumped from about $750 bn to $5.2 tn. in 1992. Over $6 tn. of interest rate swaps were outstanding at the end of 1993.[48] Activity in standard exchange traded instruments such as currency futures, stock market index options, interest-rate futures and options, and so on, reached nearly $8 tn. in 1993.[49] Despite heavy losses incurred by a few (well-publicized) firms on derivative contracts, these numbers were set to grow further as

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[46] In the developed world that is true only of Britain and Switzerland; US market capitalization is around 70% of GDP. The five are Malaysia, Hong Kong, South Africa, Singapore, and Chile. Economist 17 Sept. 1994 p. 118.

[47] Minus Japan, developed countries market capitalization jumped from $5.5 tn to $9 tn. between 1988 and 1994. David Hale, "Is the World Economy Heading for Its First Post Cold War Boom," Kemper Financial, May 1994.

[48] Financial Times 16 November 1994 p. 9. Interest rate swaps in principle can reduce the costs of borrowing overall, as well as hedge against currency risk (example: a borrower swaps fixed interest yen for floating interest dollars).

[49] Economist 25 June 1994, p. 109.

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corporate treasurers and fund managers learned better how to use these valuable tools of risk management and diversification. And they are growing not only in the US but abroad as well, in economies across Europe, Asia, and Latin America.[50]

Money is increasingly raised and borrowed internationally as well as through domestic markets, further increasing diversification in funding sources. Total borrowing on international capital markets rose to nearly $800 bn in 1993 and about $850 bn in 1994 from under $500 bn just 5 years before.[51] In 1993 US investors bought $8.4 bn of foreign equities and $19 bn of foreign bonds. During the peak year of Japan's boom (1989) that country bought $94 bn of foreign bonds and $18 bn of foreign equities; in 1992 Japan sold a net $3 bn in equities but purchased another $35.6 bn in bonds.[52] Foreign exchange trading supports international lending and international trade, of course, but is also an enormous market in its own right. No one knows exactly how large this market is but the numbers on daily turnover exceeded $1 tn. *per day* sometime in 1993.

These numbers signal more than anything else diversification of funding sources for business, investment income for capital, and currency risk management for a globalizing economy. A firm that wants to borrow money has an enormously broad range of choices: what currency, what term, what kind of interest contract, what forms of hedging against what kinds of risk, and so on. Investors can buy re-packaged pieces of risk and spread their holdings across different countries, different industries, and different time periods. While the complexity seems daunting and may lead to greater volatility for some individuals or firms, on aggregate the global economy as a whole should benefit from this kind of market deepening and diversification. Not the least benefit should be a flattening out of aggregate fluctuations, as short term ups and downs in any single market or small group of markets can be compensated for elsewhere. The argument that complex markets might act in synergy and come crashing down together simply is not supported by a compelling

[50] Listed derivatives trading in 1993 grew 28% within the US and 54.8% outside the US. Financial Times 16 Nov. 1994 p. 8.
[51] Economist 13 Nov. 1993, p. 124; 3 December 1994, p. 127.
[52] "IMF, World Economy, and Finance," Financial Times 24 September 1993, p. 5, 6, 13.

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theoretical logic or by recent empirical evidence.

Emerging Markets

The explosive growth of "emerging markets" in the post Cold War world should also contribute to dampening of the business cycle. Growth in the *developing* world has now become a major influence on economies in the *developed* world as pent-up economic energy in the developing world is released. Brazil doubled its real per capita income in 18 years from 1961; Korea doubled its income in 11 years from 1966; China did the same thing in 10 years from 1977. With new IMF estimates using PPP not exchange rates, developing countries' share of world GDP is close to 34% (instead of 17%); China becomes the third largest economy in the world, India #6, Russia #9, and Brazil #10.[53] IMF estimates for growth rates in the developing world are now typically more than double expected growth rates in the developed world. Explosive growth in even a few of these economies will change the way the world economy works.

The most direct linkage is the demand effect of a billion-odd new consumers. The numbers here are becoming legend; I simply quote a few conservative estimates to give a feel for what is at stake. The World Bank believes that in 2002 a "Chinese Economic Area" made up of China, Hong Kong, and Taiwan could have a GDP of $9.8 trillion, a little bigger than America's is projected to be then.[54] An embryonic middle class is fueling consumption booms across industries. Motorola estimates that China will by 1 997 make up half the world market for pagers. Refrigerators, washing machines, and cars are all a part of this boom – by some estimates, Asia (excluding Japan) will account for two-thirds of world increase in car sales this decade.[55] On top of this (or beneath it) is demand for new infrastructure and public investment. Estimates vary widely, but it is almost certain that Asia will spend several trillion dollars on capital investment and infrastructure in the next decade. Electrical generating capacity, roads, telephones, airports, and so on will all be built in staggering numbers.

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[53] Hale, "Is the World Economy Heading for its First Post Cold War Boom?"
[54] World Bank statistics, quoted in Economist 30 October 1993, p. 13.
[55] Thanks to Ken Courtis, Deutsche Bank, for pointing this out.

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A substantial part of this demand will be met from the West. Between 1990 and 1993 US exports to developing countries grew 36% (exports to developed countries grew only 6%). In 1993, 42% of America's total exports (accounting for 3.1% of GDP) went to developing countries; for Japan the numbers were 48% of exports accounting for 4.1% of GDP.[56] The significance of this trade became clear during the early 1990s downturn in the developed world. Between 1990 and 1993, total imports by developing countries rose by 37% which more than accounts for the total net increase in world imports during that time.[57] Continuing growth in the developing world (which stayed above 5% during this period) was an important source of locomotive energy pulling the developed countries out of the downturn.

Emerging economies will drive supply side effects as well. New competition at the low to medium end of industrial production creates concern about low-wage job losses in the developed world, without doubt. But the medium-term effects are likely to be beneficial. Competition at the low end should incite factor redeployment, new investment in human and physical capital, and a move "upmarket" by developed countries all of which spurs productivity. At the same time, terms of trade improve as the cost of rich countries' manufactured imports decline.[58] Obviously, a hard turn toward protection against developing country imports would hamper this. But the political forces that support general protectionism are not decisively strong in most Western states – in the US they lost the battle over NAFTA, over MFN for China, over the WTO. And pressures for broad protection will weaken over time as exporters and others who gain from open trade and developing country growth push their agenda forward.

Investors are an important "other". Emerging economies offer substantially higher returns than developed countries. Between 1989

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[56] Economist 1 Oct 1994 p. 12. These numbers are likely to increase as developing country growth rates continue to outpace developed country rates.

[57] Developing country exports rose by 22% during this period. Economist 1 Oct. 1994 p. 12.

[58] Example: 30% of clothing purchased by Americans is now made in the developing world, and average prices have fallen by more than 20% over the last decade.

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and 1992, American FDI in Asia rose 120% which was double the rate of increase for the rest of the world. Total FDI inflows to developing countries have risen sharply since 1990 just as FDI inflows to developed countries have fallen – so that while in 1990 developing countries attracted less than one-fifth of world FDI, in 1993 that number had jumped to nearly 45%.[59] Add to this an explosive growth particularly after 1993 in portfolio investment (that is certain to increase as financial markets in these countries develop and mature), and the result is a strong constituency of developed country investor interests that benefit from growth in what used to be the third world.

Government Policy

Developments in government policy among the G-7 countries in particular should contribute to dampening of the business cycle. With the de facto abolition of capital controls, governments deal with their revenues and outlays in an environment that is less insulated from market pressures. This constrains both fiscal and monetary policy in complex ways, but with a simple yet important consequence. The incentive to inflate away debt must decline as governments face the long term future costs of higher real interest rates that will result. Within the OECD at least, governments with larger budget deficits and higher average rates of inflation are paying higher real interest rates and the evidence suggests that this market sanction is becoming more severe in recent years.[60] It is no surprise that OECD countries have been reducing their average structural budget deficits in response.[61]

Monetary policy shows a similar anti-inflationary bias. Among central banks over the last several years there has evolved a clear, nearly consensual philosophy about the importance of price stability. The "official doctrine" is something like this: do what you can to support activity in the real economy, but do not ignite inflation. The

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[59] Economist Sept. 10 1994 p. 128. Source: UNCTAD

[60] See Adrian Orr, Malcolm Edey, and Michael Kennedy, 1995. "The Determinants of Real Long Term Interest Rates," OECD Working Paper No. 155.

[61] Excluding Japan, average structural budget deficits have declined by 1.8% GDP over the past three years. Economist 23 Dec '95 - Jan 5 '96, p. 92.

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notion that there is a policy-manipulable Phillips curve in the medium and long term is strongly out of favor among central bankers.

Even for the short term, central banks are taking the position that unemployment is not their concern. When Fed Vice Chairman Alan Blinder suggested rather mildly at the 1994 Jackson Hole meeting that it ought to be otherwise, *The New York Times* described his speech as like "sticking needles in the eyes of central bankers" and Robert J. Samuelson proclaimed that "Blinder lacks the moral or intellectual qualities needed to lead the Fed."[62] This at a meeting whose theme was the problem of "excess" unemployment in developed economies! Central bankers now agree that the unemployment problem requires boosting skills and productivity as well as increasing flexibility in labor markets so as to make fuller employment less inflationary.[63]

This signals a broader trend in which governments are increasingly adjusting to economic change by trying to enhance the operation of markets rather than intrude upon or insulate themselves from markets. Transparency is a consistent theme here (for example, the 1995 G-7 specific proposals for the IMF to support "improved and effective surveillance of national economic policies and financial market developments, and fuller disclosure of this information to market participants.")[64] Also consistent are the information "benchmarks" that matter. The Maastricht criteria for EMU tell an important story about what governments agreed to aim for: budget deficit less than 3% of GDP, debt less than 60% of GDP, inflation within 1.5% of the average of the three EU countries with the lowest rate of inflation, and no currency realignments for two years.

Consequences: IPE with Subdued Business Cycles

An international political economy with subdued business cycles in the core will operate differently than did the post war political

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[62] Keith Bradsher, "Tough-Decision Time for the Federal Reserve," New York Times 26 Sept. 1994, p. D1; Robert J. Samuelson, "Economic Amnesia," Newsweek 12 Sept 1994, p. 52. Blinder's modest Keynesian point was simply that macro policy could be used under some conditions to reduce unemployment. quoted in Robert Kuttner, "Economic Viewpoint," Business Week 26 Sept. 1994 p. 22.

[63] See for further reinforcement the G-7 Halifax Summit Final Communiqué , 15-17 June 1995, particularly pages 2, 3, and 8.

[64] Ibid, p. 3.

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economy. I have chosen here four broad areas to consider, within which I see important differences that our understanding of political economy allows us to talk about now. The four are: low inflation political economy, government policy, north-south relations, and the role of international institutions. Although they overlap and interact, I discuss them separately for clarity. The arguments here are not exhaustive of the possibilities, and they are not point predictions or attempts to prognosticate future events. They are selected logical explications of trends that I believe will shape and influence events.

Low Inflation Political Economy

The distributional effects of low inflation will impact heavily on international creditor-debtor relationships. Current debtor countries could find themselves in the worst of all possible worlds, since they are borrowing money on contracts with inflationary expectations still built in and paying an inflation risk premium in a world that will actually have low inflation. Creditors reap that premium as a windfall profit. "Growing out" of debt will become harder. Some developing countries may succeed in doing that, but there will almost certainly be a much larger number of "losers" (moderate growth countries) saddled with increasingly burdensome debt. Certainly many debtors will find default or re-negotiation and re-scheduling of debt to be their principal options. Does this signal the likelihood of another international debt crisis?

Possibly so, but there are countervailing forces at work. Primary among them is the change in the make-up of financial flows from rich to poor parts of the world. The move away from bank lending toward FDI and portfolio investment means that many losses will be absorbed in equity, rather than threatening the viability of money center banks. Thus debt re-scheduling need not have the "systemic crisis" character that it did during at least part of the early 80's experience. Over the medium to longer term, low inflation will itself repair some of the damage that it inflicts in the short term – since as expectations shift, inflation premiums in lending will decline and there will be new access to money for developing countries as risk/return ratios are clarified. Better bank profits in the developed world will continue to reverse the restrictive effects of the early 1990s banking crisis and further stimulate new lending as balance sheets improve. Overall, steady and low inflation rates should improve the

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efficiency of capital allocation around the world by removing noise from the calculations, also contributing to the potential for effective lending. All of this is quite salutary, given the new demands on capital from the developing world.

Low inflation will also affect employment issues in the developed world. The industrial states face an unprecedented challenge of structural adjustment to competition from the NECs. "Lost jobs" are now a major political issue in the G-7 states, even if economists disagree about whether it is low-wage NEC workers or technological change (or some combination) which is driving out those jobs. The question becomes, how will developed countries respond?

Protection, which I discuss later as a possible "de-railer" of my story, will certainly be part of the response. But the greater advantage will go to countries that move to sell products to the developing world while buying cheaper inputs from it. This creates stronger incentives to invest in human capital and training that can differentiate further the work force in the developed world from the work force in the developing world (and thereby maintain the productivity bonus that must be in place to compensate for wage differentials). But even with increased human capital investment, there will certainly be some permanent displacement of labor in the developed world and a likely increase in structural, permanent unemployment relative to cyclical unemployment. This could have significant political repercussions if it means a permanent underclass of long term unemployed, and particularly if that underclass overlaps strongly with racial or ethnic divisions. The implications for societies that view themselves as modern democracies with equal opportunity are troubling, but no one has yet devised a cogent strategy to deal constructively with this issue.

One strategy that some states might find politically alluring is currency devaluation for competitiveness. The logic is simple: in a low inflation but relatively high unemployment world, devaluation makes exports more attractive abroad, raises the price of imports, and thus save jobs at home.[65] Since many states are similarly tempted,

[65] In a floating exchange rate system, states do not devalue their currencies per se but they can take steps that induce currency devaluation by the markets, for similar effect. I believe that the US has pursued some variant of this strategy over the last decade or so; others would disagree and say that the value of the dollar reflects market assessments and the

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the stage is set for a competitive race to devalue. This downward spiral logic (which would end with no competitiveness gains but only increased inflation) could apply anywhere in the world. G-7 states will want to avoid the possibility of getting themselves into this viscous circle. One way to do that would be to agree a currency scheme, either formal or informal, for dirty or managed floats, targets zones.... perhaps even fixed exchange rates? (I return to this point later).

Within the EU incentives to avoid the downward spiral are even greater, because competitive devaluation would be particularly damaging in Europe. The reasoning is straightforward. Devaluation boosts competitiveness in part by causing a real pay cut for domestic workers, who following devaluation have to pay a higher price for imported goods. If workers demand and receive higher wages that fully compensate, then the competitiveness gain is lost and what remains is inflation. In Europe, workers are likely to demand increased wages quickly because a relatively high percentage of what they buy is imported – hence devaluation raises their costs of living visibly and fast.[66] European workers are also more likely to receive some of their pay demands, as real wages are far less flexible downward in part due to more effective labor unions. Competitive devaluation within the EU would turn out relatively quickly to be futile, and the political tensions that would undoubtedly accompany it might place at risk the achievements of the single market – along the lines of the French response to British "social dumping" when Hoover Vacuum took French jobs offshore. These particularly intense downside risks in Europe create additional incentives for the EU to move toward fixed currencies or a single currency *sooner* rather than later.

Government Policy

I consider here two areas of impact on government policy in the developed world. Governments will find fiscal policies (particularly deficit financing) and exchange rate policies more tightly constrained

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continuing twin deficit problems of America.

[66] This is less true in America where imports account for only 12% of GDP, whereas in Germany imports are 30% of GDP; in some smaller EU states close to 50%. 1994 statistics from International Monetary Fund, International Financial Statistics June 1995.

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in a world with subdued business cycles.

Low inflation in principle should affect governments similarly to how it affects other borrowers. But governments have had various ways of dodging fiscal discipline. Markets price government debt under conditions of great uncertainty about the "real" fiscal position of states. One reason is that government deficits are broken down analytically into two components – a structural component and a cyclical component. Adjusting government deficit measures for the business cycle is a little bit like adjusting employment or sales statistics for "seasonal variation" – only much harder.

The cyclical component of a deficit is supposed to reflect changes in spending that governments do in conjunction with business cycles. This includes so-called automatic stabilizers – changes in tax revenue, unemployment outlays, etc. that happen directly through phases of the business cycle. It also includes discretionary spending that is responsive to cycles: infrastructure contracts, public sector wages, industrial subsidies, and the like. The structural component of the deficit is (at least conceptually) the "built-in" overspending that would still be in place after cyclical components were removed. In practice, it has been very hard to determine what the structural components of the deficit add up to, mainly because calculating the cyclical components is hard and made harder by country-to-country variance in accounting procedures, characteristics of automatic stabilizers, and so on. This leads to uncertainty about structural deficits and the real, long term, fiscal position of states. Uncertainty makes debt harder to price and leads to the misallocation of resources by markets.

But the inherent cyclicality of government spending will decline as business cycles dampen. This will clarify the real fiscal position of states, both for the markets and for government decision makers (as well as for voters). A number of interesting effects are possible. As automatic stabilizers diminish in importance, governments will have more room to use discretionary stabilizers in a prudent and effective manner. Government agencies should find it easier to project revenues and expenditures. At one level this is helpful since planning will be made easier. At another level, it complicates governments' ability to hide behind excuses about "cyclical" deficits that would supposedly correct themselves when "the recession ends". Politicians will be challenged to defend budget proposals that incorporate widely

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varying assumptions about growth rates, inflation, tax revenues, etc.[67] Governments (and voters) will know better where state finances actually stand. So will markets, and that knowledge will improve the pricing of government debt. This kind of transparency in turn will yield increased pressure to reduce deficits. It is likely that pressure will fall particularly hard on developed countries with particularly high debt to GDP ratios – such as Sweden, Italy, and Belgium.[68] If I am right here, then the Maastricht convergence criteria (particularly the 60% debt/GDP limit) *reflect* just as much as they *drive* the need for tighter fiscal policy.

Exchange rate policies will also be subject to additional constraints. I differ here with the common wisdom, which generally sees floating exchange rates as the nearly certain future of international monetary matters and rejects as almost inconceivable the notion of a new arrangement to fix exchange rates among the advanced industrial countries.[69] I differ also with the thrust of Jeff Frieden's related argument that exchange rate politics will become more contentious in a world with capital mobility.[70] Both arguments identify important factors and neither is wrong. But there are strong countervailing forces that will push in the other direction, making exchange rate politics less contentious than Frieden expects and the move to some kind of fixed or nearly-fixed rate system more likely than the common wisdom allows.

The incentives states have to fix rates are familiar. Fixed rates reduce transaction costs for international trade and finance; the more interdependent states are in trade and finance the more important the effect. Export-oriented producers of tradable goods gain from

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[67] A classic trick of "deficit cutters" has been to draw up budgets with rosy assumptions about inflation, unemployment, growth, tax revenues, etc.... assumptions which are then attacked as unrealistic by the other political forces.

[68] Each has debt/GDP ratios over 100%.

[69] This argument is supported in the political science literature by a broad reading of hegemonic stability theory -- which implies that monetary cooperation (and particularly the very high level of cooperation that would be necessary to create and sustain a new fixed rate system) is less likely in a world without a hegemon. I am using the term "fixed rates" here as a shorthand; target zones or some similar kind of semi-fixed system, managed or dirty float, etc. would fit my argument.

[70] Jeffry Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," International Organization 45, Fall 1991. pp. 425 - 51.

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fixed rates, as do investors in international bank and bond lending and portfolio investment. Fixed rates have the additional attraction of avoiding the temptations for competitive devaluation that I discussed above. These incentives are all in place.

The argument really turns, however, on the strength of the *disincentives* – the reasons why states shun fixed rates. In a world with capital mobility, the major trade-off with exchange rate stability is monetary policy autonomy. As the EU found out so vividly in its 92-93 currency crises, states cannot have capital mobility, fixed exchange rates, and autonomous monetary policy all at once. The standard argument is that (since capital mobility is generally agreed to be here to stay) states choose autonomous monetary policy and give up exchange rate stability as the necessary cost. But will this choice be quite so clear as business cycles dampen?

Perhaps not. In a world with dampened business cycles monetary policy autonomy could become much less important. The current consensus among central bankers may already reflect some of this effect, since if cycles were making increasingly strong demands on monetary authorities to compensate with the kinds of aggressive policies more familiar in the 1980s it is certain that the consensus would be under strong attack. With dampened business cycles states will have less need for monetary policy autonomy under regular circumstances. Surely there will still be unexpected and exogenous shocks that call for changes in monetary policy. The question then becomes, could necessary adjustments be coordinated successfully within the fixed rate system? There are many reasons to think it would be hard, and many of those reasons would still be operating in a world with dampened business cycles.[71] But there is a significant countervailing force. Cooperation would be easier because the need of one country to change rates would be easier for others to see, evaluate, and understand – primarily because of a higher signal to noise ratio in economic data. I am not saying that cooperation would be easy or that it would happen, but only this: the possibility of agreement to fix exchange rates becomes significantly higher in a world with subdued business cycles.

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[71] Ibid, pp. 449 - 451; also Martin Feldstein ed., International Policy Coordination, Chicago: University of Chicago Press, 1988.

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North-South Relations

A central question in the political economy of North-South relations is whether the progressive liberalization of developing economies over the last decade or more (which has been a crucial driver of rapid development in the South) will continue. Without necessarily agreeing on the underlying causes of liberalization, it is possible to list a set of conditions that are probably necessary for it to be sustained. These include continued global growth, open markets for trade, stable and substantial capital flows, technology diffusion, and progress on management of environmental problems.[72] Dampening of the business cycle in the core should contribute positively to at least some of these conditions.

The argument here is simply that continued progress in the South depends heavily upon the scope and speed of adjustment in the North. The economic challenge from the new exporters of the 1990s dwarfs the previous decades' challenge posed by the NICs. South Korea, Taiwan, Hong Kong, Singapore are small countries. In 1965 they had 1/20th of the OECD's population and made up 1/2% of world production and 1.5% of world exports. Twenty years later the NICs had increased their share in world production 5 times and exports almost 6 times. But the absolute numbers remained small – 2.5% of world production and 8.5% of world exports. Contrast this with the new exporters – China, Indonesia, Malaysia, Thailand, Vietnam – which together make up almost a third of the world's population, double that of the OECD. Today they account for about 4% of world industrial production and 5% of exports. But if their growth continues, those numbers could rise to much higher levels than was conceivable for the tiny NICs. The challenge is happening fast, with growth rates in China still hovering around 10%, while Indonesia and Vietnam approach a take-off point (along, perhaps, with the Philippines and India?).

Adjustment to economic change of this magnitude cannot be easy under any circumstances. But there are a number of reasons to think it would be somewhat easier with subdued business cycles. The

[72] Obviously these are not sufficient conditions. See, for example, UNIDO, Industry and Development, Global Report 1985, Vienna: UNIDO, 1985, p. 5.

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argument is that moderate growth provides a more auspicious environment for adjustment than does boom and bust (even if the trend line were the same). The main issue for the North is redeployment of capital and human resources. This requires training, education, research and development, and investment. Steady growth with low inflation should facilitate stable expenditures on each and longer term planning by businesses, individuals, and governments. Deep downturns, on the other hand, transfer votes and power to protectionist forces. If there are no deep downturns, protectionist forces can be more easily kept at bay, bought off, re-directed, and conciliated. With steady growth, it becomes possible to foresee progressive (albeit gradual) opening of markets and a more constant companion flow of ideas and technology between north and south. Just as important would be the relative stability of FDI and portfolio investment flows to accompany (and partially drive) the continued growth of stock and bond markets in the developing world.

Immigration remains a potential problem of increasing political significance in the North. Clearly, immigrants are less welcome in stagnant economies and are more likely to be accepted (or even coveted) during periods of growth. How would subdued business cycles change this dynamic? The challenge is severe in any scenario. Developing countries contain around 80% of the world's current population. Since birth rates are stable in the US and declining in much of the rest of the developed world, demographers project that almost all net growth in world labor supply over the next 30 years will take place in developing countries. In an open world economy, capital and labor seek each other out. Two things can happen: either large scale migration of labor from South to North, or outflows of capital from North to South. Immigration (with all its attendant problems) is more likely when capital outflow is low, particularly when it is restricted by factors on both sides. Many of the barriers on the recipients' side have come down. As capital markets deepen in the South, bank lending, FDI, portfolio investment, and so on from the North will be facilitated. Dampening of business cycles should flatten out some of the boom-bust character of capital flows (particularly portfolio money) and promote a more regular and predictable transfer of investment to new productive capacity. The stark truth is that most political forces on both sides of the North-South divide prefer capital flows to immigration, so this "solution" is

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likely to grow and immigration could actually become less not more of a problem in the future.

International Institutions

Dampening of the business cycle will affect the roles that international financial institutions play in the world economy. The World Bank and the IMF, for example, may find themselves going "back to the future" and performing functions closer to their original founding ideas.[73] Interestingly, recent proposals from the 1995 Halifax G-7 summit track some of these points.

Private flows of capital and information will be facilitated by the changes I have discussed but will retain imperfections. There will likely be more "Mexico 94"-type crises where cascading short term expectations destabilize capital flows.[74] Such panics should become less likely with subdued business cycles but if they happen nonetheless institutions could usefully provide a second line defense of stabilization through insurance schemes and containment mechanisms. At Halifax, the G-7 made moves in this direction, proposing that the IMF establish a new "Emergency Financing Mechanism" – which would provide faster access to Fund arrangements with strong conditionality and larger upfront disbursements, and asking some members to contribute toward doubling the funds of the General Agreement to Borrow in support of this function.[75]

Institutions will also have added incentives to help states in improving transparency. G-7 and OECD countries don't need much help (since they have elaborate monitoring schemes among themselves), and these will become more efficient as business cycles dampen. But for less developed countries, the Bank and Fund are already an important repository of information and could build on that role to become more efficient, reliable, and comprehensive than private credit/risk rating systems. Information improves the efficiency of markets but also works as an early warning system for potential difficulties. Again, Halifax made very positive suggestions on this

[73] For brevity I consider only these two, as examples.

[74] It is possible to say this about proximate causes without passing judgment on the underlying causes of the crisis, and I intend no such judgment here.

[75] G-7 Halifax Summit, Final Communiqué, US Department of State, 17 June 1995.

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score, urging the IMF to "establish benchmarks for the timely publication of key economic and financial data... establish a procedure for the regular public identification of countries which comply ... [and] insist on full and timely reporting by member countries of standard sets of data" – a proposal to which a number of states have now agreed.[76]

The IMF, established originally as a coordinating club for the Bretton Woods fixed-but-adjustable exchange rate system, is the obvious candidate to manage and provide technical support for any new fixed or semi-fixed exchange rate regime set up among the major world currencies. Its role would be primarily surveillance and information provider, as well as a forum for negotiating changes in rates or target zones.[77] It is almost inconceivable given the extent of private capital markets that any major countries would turn to the IMF for balance of payments support, so that function (as well as the conditionality that attaches to stand-by agreements) would stay specific to the less developed countries and would continue to overlap with Bank activities. The most likely division of labor here would keep the Bank in the business of facilitating longer term developmental goals, with the IMF refocusing itself on short term response to shocks (oil-prices, commodity prices, etc.).

Even in a world with sophisticated and deep capital markets there will still be a role for development lending through international institutions. But it is unlikely that the Bank can continue to lend as it has principally to governments or government guaranteed projects in less developed countries. An updated rationale would portray World Bank funds as sparking and facilitating private investment through signaling, insurance schemes, subsidies and guarantees, and so on, for projects that private money might miss or sidestep. This would be an explicit way of subsidizing poorer countries for the purpose of easing their economies into global capital markets. Under a similar rationale, the Bank could also play a part in the restructuring of debt that I argued above will be a short-to-medium term consequence of dampened business cycles. These

[76] G-7 Halifax Summit, Final Communiqué, US Department of State, 17 June 1995.

[77] I suggest the IMF here because although the countries involved would be primarily the G-7, that group does not have the institutional infrastructure and technical expertise that reside in the IMF.

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suggest very large changes in Bank corporate culture, organization, and strategic thinking – changes that are immensely difficult but not impossible in an environment where the bank's most powerful state "underwriters" are demanding change, and increasingly with a consensus voice.[78]

Conclusion

I see three prominent issues that could change dramatically the central arguments of this paper.[79] The unemployment effect in the core; production blockades; and security problems are sources of possible shocks now foreseeable that could challenge the scenario I've laid out. here. I comment on each issue briefly.

"Adjustment unemployment" in the developed world will continue to generate pressures for trade protection, restrictions on immigration, and similar measures. These pressures will almost certainly get worse before they get better. Neither declining real wages for the working class nor extensive long term unemployment is politically sustainable for long in modern democratic societies. The upside is that much of what needs to be done here – at least in terms of setting incentives – to encourage investment, re-tooling, and re-training is within reach of government policy.

Clearly, developed country governments need to do more to address the fears and the real consequences of unemployment at the low-skill end. The US now invests a pitiful 0.05% of GDP in labor programs and training (compared to 0.25% GDP in Germany and 0.22% in UK). The auspicious signs here include the G-7's new focus on this problem, symbolized by the jobs summit held in Detroit in 1995. The Clinton administration's emphasis on "economic security" could lead to policy initiatives (particularly in the wake of failed health care reform) that focus on other labor market measures (like education and training) that contribute more directly to productivity.

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[78] The European Bank for Reconstruction and Development (EBRD) provides an interesting example of an updated rationale for development lending.. See Steven Weber, "Origins of European Bank for Reconstruction and Development", International Organization 48 pp. 1-38; and the Halifax Summit Communiqué, particularly page 5, where proposals for the Bretton Woods Institutions reflect new approaches to lending that were pioneered by EBRD.

[79] Obviously this is not a comprehensive list.

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It is unfortunate that there was no single post Cold War conference to dramatize the importance of this challenge, but there have been a series of smaller successes – from the Maastricht treaty to the conclusion of the Uruguay Round to the passage of NAFTA. Leadership, particularly in the US and France, will be an important factor in how quickly and with how much strife this issue is managed. Leadership is inherently unpredictable, but the structural forces driving adjustment are not and they are getting stronger. A decisive shift toward policies of protection seems unlikely in this environment, but it is not impossible.

"Production blockades" will certainly arise in both the developed and the developing world; the question is, will they be severe enough to de-rail continued growth. Capital shortages, a common concern a few years ago, now seem unlikely. Capital markets are growing as or more quickly than demand for capital, and new calculations show that Asia could very well finance much of its growth through savings. Energy shortages are possible. An oil price shock that lasted for more than a short time would be a serious problem. But that seems increasingly unlikely given the state of the market and the improving political situation in the Middle East. A moderate, gradual, appropriate rise in energy prices reflecting increased demand (particularly in Asia) would be manageable, and arguably even good for a number of other reasons – including the environment. It is the environment which seems most likely to throw up unforeseen production blockades, and possibly on a scale large enough to derail my argument. Although no sign of environmental disaster on that scale looms, the possibility cannot be dismissed.

Finally, "security problems" have the potential to wreak havoc with any scenario of the international political economy. The question really is one of magnitude. The border disputes and aggravated civil wars that have so far been the stuff of post-Cold War security seem unlikely to spread (geographically, or in political repercussions) so as to threaten the basic processes I have outlined in this paper. The larger and more dangerous issues remain abstract.

The next decade will witness dramatic changes in the location of economic power around the world. As in previous eras, race, religion, and ideology are overlaid on top of shifting wealth. I have not addressed in any detail here the potential consequences for major international conflict; it is too soon to do that satisfactorily. Some

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questions, however, are clear. Cooperation among the G-7 on a range of issues, which I find more likely in a world with diminished business cycles, is important – but is it sufficient and decisive? China, Russia, and similarly unstable situations lurk in the background and will likely provide at least a dose of nervous uncertainty. As still-developing countries, however, their prospects for stabilization should improve just as other "Southern" countries benefit from a world with dampened business cycles in the core.

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BOOK REVIEW ARTICLE

The "Warp-Speed" Transformation of the World Economy: A Discussion of Ten (of the Many) Recent Books

Dwight D. Murphey
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Government commission reports in the United States often seek to capture public attention by opening with dramatic and highly exaggerated warnings. I am aware that I am about to start this article in much the same "alarmist" tone. If there were a way to understate what I am about to discuss and yet relate accurately to it, I would do it.

The point will be that at the close of the twentieth century we live in the period of the most rapid scientific and economic – and, therefore, we must understand, social, political, ideological and institutional – change in human history. Change is taking place on a scale heretofore unimaginable and is accelerating at what science fiction calls "warp speed."

This is change full of the most astonishing promise, with goods and services soon to become available of a type and on a scale never before dreamed of. The hopeful implications of the promise are by themselves enormous. Bill Gates' book, one of those reviewed here, shows a whole new world of possibility. Simultaneously, however, the change is chewing up and spitting out much that is central to the lives of individuals and of peoples as they now exist. Despite much anxiety about layoffs and "downsizing," Americans have just begun to feel its effects.

This radical change marks a sharply accelerated advance of a process underway for centuries. With the Industrial Revolution, hundreds of millions of people worldwide migrated from agriculture into industry (without, by the way, any slackening of the increase in agricultural productivity). As recently as the past half-century, advanced economies have seen a migration from industry (which also has nevertheless continued to grow in productivity) into service occupations. And now science and computerization are quickly

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accomplishing a revolutionary final step: through robotization, biotechnology and such things as the "paperless office," they are supplanting human effort *in virtually every area*.

The world is only at the beginning of this displacement, but it is everywhere to be seen and felt. The "downsizing," "restructuring" (which is largely a modification of organizations to match the new technology) and displacement of workers[1] that are now seizing the American middle class do not mark a passing phase; although the process will no doubt be subject to many temporary offsets and may even be delayed considerably by the inertia created by existing lines of effort and of capital investment, it will continue as a powerful secular trend.

In this context, we will need to distinguish between the displacement of individuals, firms and industries that causes millions of people to search for new ways to make a living, which is a temporary or "frictional" form of displacement that is most certainly going to be a major phenomenon throughout the world in the decades ahead; and the more "ultimate" displacement that *may* occur because very little production of goods and even services will, as the process plays itself out, come to require any substantial amount of human effort.

If hundreds of millions, indeed billions, of people are to be displaced, in the second of these senses, from the income-earning process by a technology that is capable of vast productivity and wind up with no other route by which they share in the productivity through a contractual nexus, the wishful thinking of countless socialist authors over the past two centuries will largely come to fruition. It is they who have downplayed the need for productivity while stressing the centrality of distribution, have thought more in terms of abundance than of scarcity, have denigrated the self-executing processes of the market economy in their preference for "rational" systems, and have generated a moral outlook that has emphasized "entitlement" over the work-ethic and personal responsibility. As a "classical liberal" (i.e., a supporter of limited government, a market

[1] It is important to point out that by "workers" when I speak of "the displacement of workers" I mean far more than just "workers" in the traditional sense. The displacement extends to those who perform effort of all kinds, including management personnel, and even to firms, whole industries, and institutions.

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economy, and a whole complex of ideas and institutions that go with "individual liberty"), I have detested the entire syndrome of socialist thought as a threat to much that I think imperative, so it is with deep reluctance rather than alacrity that I see economic realities moving even potentially in its direction. Either vast temporary displacement or an ultimate permanent supplanting of people poses a radical new challenge to all non-socialists and, as with this reviewer, enemies of socialism. If it is true, as Jeremy Rifkin (one of the authors discussed here) argues with great plausibility, that the market paradigm for the organization of economic and social life will soon cease to provide rewarding roles (and a living) for all who seek to participate, how then are economies, and even societies, to be organized? Any supporter of a market economy who fails to think this through, and think it through quickly, will within a very short time find himself talking to a world that *was*, not to the one that *is* or, most especially, to the one that *very soon will be*. Without unprecedentedly rapid intellectual adaptation and appropriate policy suggestions, the supporters of a market economy will come to look ridiculous – most probably even despicable – to those who suffer during the immense displacement. That, if it occurs, will be a tragedy of Wagnerian proportions, since it is precisely the values traditionally associated with a "free society" predicated economically on the market that the world will desperately need at the heart of any redrawn social organization. Those values will be vital, also, during the period of transition; without them, the transition offers to become catastrophically explosive.

A growing literature addresses the economic and technological issues (and even some of the larger social issues, although most of the present writers address them from a socialist point of view, since such subjects have been fully in line with socialist aspirations). The ten books discussed here are just part of that literature, which I am studying in preparation for a planned book. Other than to acquaint the reader with these books, all of them valuable, and some of their implications, I won't presume at this time to offer a full analysis or solutions. Instead, it will be well to consider this discussion an invitation for more thought, and not as a commentary set in stone; if my fellow "conservatives" (in the popular American sense) and classical liberals can show that a fully market-oriented system can continue to function well (which they will predictably be more than

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anxious to do), they are most welcome to do so. It will be foolish of them to attempt that, however, unless they have *fully* considered these issues.

When things are changing at warp speed, different authors will inevitably peg their discussion to different points along the arc of change. Some look ahead a few years to its full fruition;[2] others hardly seem aware of the changing paradigm, and talk in terms of the market economy as we are accustomed to thinking of it; others are somewhere in between. It will be important to notice where each author places his focus if we are to understand the context in which he is speaking.

Simultaneously, it will be important to realize that economic proposals that might be forward-looking in terms of the problems under one state of conditions may not be at all appropriate for the conditions that will come to exist within even so few as five or ten years. Accordingly, the acceleration of change is itself one of the central points that any economic and social analyst must keep in mind.

This review will start with the recent books by Jeremy Rifkin, Paul Kennedy and Bill Gates because they look farthest ahead (although it may surprise the reader to know that, because the change portends to come upon us so rapidly, even that would seem to involve looking only two or three decades into the future). This will give them desirable emphasis, since in my opinion they are the most important of the ten. Moreover, it will serve to identify the "end-point" of the change so that the other books can be understood as occupying intermediate ground along the continuum.

The End of Work: The Decline of the Global Labor Force and the Dawn of the Post-Market Era
Jeremy Rifkin
Tarcher/Putnam Books, New York, 1995
Paperback, 350 pages, $15.95, ISBN 0-87477-824-7

[2] When I speak of "full fruition" with regard to the change, I mean the process of the near-total displacement of work by automation. This is not meant to suggest that the social, moral, political and economic consequences of the change will not continue to work themselves out for countless generations.

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It is Rifkin's book that most graphically tells the story of what is happening to work through the technological revolution. He predicts that work (human effort) will virtually disappear from manufacturing "by the early decades of the coming century" and from the service professions within a half-century. (We will see that Bill Gates thinks otherwise.) Agriculture, in which at one time virtually the entire American people were employed, already occupies only about three percent of the U.S. population, and worldwide the developments in biotechnology will displace hundreds of millions of farmers. Rifkin tells us that the first fully automated farm will be underway in about twenty years.

Much of the book's strength comes from its specificity. Rifkin isn't afraid to generalize, but he gives countless specifics, with analysis of why they are occurring. Here are just a few, which I cite to acquaint the reader with the practical substance of what is happening:

- He tells how the mechanical cotton picker came into use in the mid-1940s, resulting in a rapid displacement of labor, mostly black. Six percent of the American South's cotton was harvested by the new machine in 1949; 78 percent by 1964; *and 100 percent by 1972*. Further displacement came through the introduction of chemical defoliants to control weeds. The social effects were enormous, with this displacement being one of the main causes of the migration of five million blacks to the cities of the north and west. But the need for employees in heavy industry began its own decline, with the number of jobs eventually being cut drastically. As a result of these factors (and others that Rifkin doesn't think to mention), a permanent underclass came to exist in the inner cities.
- In mining, more coal is removed from the ground now than in 1925, but with far fewer workers. In 1925 almost 600,000 were needed to mine 520 million tons; in 1982, only slightly more than 200,000 for 774 million tons; and in ten years this will fall to not much more than 100,000.
- In the advanced economies that belong to the Organization for Economic Cooperation and Development (OECD), the production of finished steel declined by just six percent between 1974 and 1989, but jobs were reduced by 50 percent, with a cut of more than 1,000,000 jobs.
- The world demand for skilled machinists is dropping. "Powderized metals are merely poured from bags into pressurized

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molds" and "lightweight ceramics and plastics" are taking the place of metal products.

- Science is affecting not just industry, but is about to subject agriculture to yet another revolution, this one going far beyond anything the world has seen so far. The "biotechnical revolution" has begun. Pest-resistant genes are "engineered directly into the biological codes of plants." Plants are restructured genetically "to tolerate drought or extreme heat and cold." Growth hormones have led to a "milk glut." "Genetically engineered hens" lay more eggs. The result? "Technological forces are fast replacing outdoor farming with manipulation of molecules in the laboratory." Rifkin tells how 70,000 farmers on Madagascar make their living raising 70 percent of the world's vanilla. But "now the new gene-slicing technologies allow researchers to produce commercial volumes of vanilla in laboratory vats...eliminating the bean, the plant, the soil, the cultivation, the harvest, and the farmer." He tells how work is progressing on a sweetener, producible in the laboratory, that is 100,000 times sweeter than sugar. Cotton can be grown "in vitro," and "the day is not far off when orange juice will be grown in vats, eliminating the need for planting orange groves." With the advent of tissue culture, "the goal is to convert food production into a wholly industrial process."

- If those who are displaced in industry or agriculture think, as they have in the recent past, that they will be able to find employment or new business opportunities in the service sector, they will find that there, too, the displacement is progressing rapidly. At AT&T, a voice-recognition system has taken the place of 6,000 long-distance operators. Modular preassembled equipment has cut back on the need for installers and repairers. At the post office, sight-recognition machines recently displaced 47,000 workers. More than 20 percent of bank employees will be "riffed" (ousted by "reductions in force") within the next five years, and this is on top of the elimination of 179,000 tellers during the ten years preceding 1993. Still further, "the paperless electronic office has now become a goal of modern business." Business still stores 90 percent of its data on paper, but soon the printed page will virtually be eliminated "in favor of electronically stored information." In this context, "the number of secretaries has been steadily declining."

- Wholesaling and retailing, with all that they involve by way of malls, stores and sales employees, are for the most part on their

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way out. "In 1992 the wholesale trade industry lost 60,000 jobs...By early in the next century most wholesaling, as we have come to know it, will have been eliminated" as producers interact directly with consumers by direct mail, catalogs, and increasingly through the Internet.[3] Electronic shopping will make retail shops and malls obsolete. Rifkin tells us that "since 1989, more than 411,000 retail jobs have been eliminated." And the process has barely begun. Nor should it be thought that the food service industry will pick up the employment slack. In restaurants, orders are increasingly sent to the chef by computer, the customer's check is prepared electronically, and inventory is monitored by computer. Soon, patrons will order by "touch-sensitive screens that list the items on the menu." Even the cooking is becoming automated. These mark only a few of the illustrations in *The End of Work*. They and many others make the book a fascinating compendium of events around us. They point toward both frictional and ultimate displacement. Reading about them will help train the reader's eye to notice the continuing stream of news reports about additional displacements.

After all this, it may be surprising for me to say that Rifkin is not primarily a "futurist." He doesn't speak just of what *will* occur; he also recounts the history of what has already happened. And he discusses the broader social issues.

Contrary to wishful thinking, he says (in contradiction to Gates), a permanent displacement can be foreseen. The advancing technology will not for the most part create new jobs for those who are displaced, *since the new technologies, when they are fully implemented, will not themselves require many workers.* (We can imagine, though, major demand for certain types of workers as human effort is used in the highly creative process of inventing and then installing the new technologies.) Retraining may for at least the lifetimes of many now living be the answer for a large number of people in the world as it still is, which is a world where rich opportunities remain for those who hustle, as Bill Gates makes clear.

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[3] I hesitate to speak of something such as the Internet, which is a fast-growing worldwide interconnection of computers, because no such thing has any permanency. What we have today is just the "first generation" of something that readers in the future will recognize under a different name and that is suggested by the term "information superhighway."

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But as the displacement continues into its farthest reaches, the question becomes "retraining for what?" Even temporary ("frictional") displacement as people retool for new careers will be tenuous, as one firm or even industry after another fails, taking down the people who have trained themselves for it.

Two issues will loom ever larger: how to handle the social cataclysm and personal hardships arising out of vast frictional displacement; and how ultimately to organize an economy (and a society) that is no longer centered on work. A market economy may be able to continue as central if it eventuates that there are a large number of highly paid jobs and business opportunities and if there are a great many people who are stockholders who thus share in the income from the immense productivity, with all of these people in turn spending in a way that provides employments, on at least a part-time or short-workweek basis, for the millions of others. But surely this is problematic, and for many societies, such as perhaps Madagascar in the example Rifkin cited, it will not describe the situation. Nobody knows with certainty where the whole process will lead and how any given country, people, industry, firm or individual will be impacted upon.

For anyone other than a traditional socialist, these things raise profound ideological and moral issues, since the market will include growing numbers of people about whom it will no longer be accurate to say that "they are not doing well because they lack the work ethic." (There is an ideological tendency on the part of those like myself who embrace the work ethic to write off people who fail as "just being lazy" even though the failure is attributable to vast forces beyond the control of the individual. My parents used to point to members of WPA work crews in the 1930s as slackers, totally overlooking the fact that there was a depression on. For conservatives, classical liberals and libertarians to think through the new realities, they will have to become much more sophisticated in their judgment about when failure is the individual's fault and when it must be laid to the door of systemic problems. This is exceedingly important, because history tells us that the extent of people's willingness to "write off" even millions of other people out of a lack of sympathy knows no bounds).

Inherent in my comment about this is the fact that I see the theory of a free society in terms of a whole systems analysis, and not as simply a series of deductions from a few over-simplified premises.

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Those who hold to the latter, which is a very common way of thinking, will find themselves rooted in modes of thought that the world will find more and more unrealistic. Forty years ago, I took time off before going to law school to attend Ludwig von Mises' classes and seminar at New York University, precisely because I was concerned about whether economists had really found the answer to the trade cycle and such crises as the Great Depression. It seemed to me then, and continues to seem apparent to me now, that a market economy will forfeit the allegiance of people in general if it is structurally deficient and is subject to any major inability to serve the needs of all who are willing to work. Looking on it as a system is essential.

Taken just by themselves without projecting an *ultimate* displacement, the problems of *frictional* displacement will need to be addressed as society experiences the process of change. But the manner of meeting those problems at any given time may take us far afield if we don't, all the while, have some idea of what the problems will be in even so short a time as five, ten or fifteen more years. A longer view will be needed to inform the shorter-term understanding. Here, I am thinking of Ravi Batra's book, one of the ten under review, that proposes a high tariff wall while we break all large firms into many small ones. For reasons we will discuss, his "competitive protectionism" is intended to address the deterioration of American income as we've experienced it, but may be ill-suited, at least in part, to meet changes that will come quite soon.

In common with the majority of authors writing on the subject so far, Rifkin's own orientation is socialist, although that seems to have played a negligible role because he is recounting facts (although necessarily with considerable speculation about the speed and ultimate thoroughness of change), not ideology. The Foreword is by Robert Heilbroner and there are several references to the likes of Marx, Engels, Marcuse, Theobald, Sismondi and Bellamy (along with one to Milton Friedman, who is of course a champion of the market).

Before we leave *The End of Work*, three additional implications should be discussed in some detail:

First, the scenario of near-total displacement of workers in an economy of hyperproductivity will tend rapidly to put into question almost all features of current economic and fiscal discussion. This is a point that will come up in varying degrees in our discussion of the

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other books.

Concern over growth of a nation's Gross National Product, say, might well become meaningless (although military preparedness will always have to be looked to) in a situation where the world is awash in goods and services. Sometimes we read that the growth of U.S. GNP has been "sluggish." There is much, however, that GNP doesn't take into account, and there is little question but what productivity in all advanced countries will skyrocket once organizations, infrastructure and capital investment have more completely made the transition to the new technology.

A smaller point is equally illustrative. We hear much concern about how the Social Security System in the United States will come under impossible pressure when there are only three workers for every retired person. Our need to redirect our thinking, often to the diametric opposite of our current opinion, is brought home if we realize that, in light of the rapidly advancing near-workerless economy, three workers *may be too many.*

The concept of "comparative advantage" has been central to thinking about international trade since Ricardo. But the new developments suggest that it will cease to apply, since it will no longer be a matter of everyone's finding a niche to produce any one part of the goods and services that are possible. The big issue might well become the sharing, or non-sharing, of technology, far more than of trade. The importance of resources and their geographical distribution will also be accentuated.

Even the concern over Americans' inability to compete with subsistence-wage foreign labor, much of it highly skilled, in a milieu of free trade may soon be bypassed, since it appears that *nobody*, not even the 30-cents-an-hour foreign worker, will be able to compete with the new workerless technology. As odd as it may seem, the concern over international competition and the movement of jobs abroad is in this context only an intermediate concern, soon to be outdated.

But that concern is itself "further along the curve" of such projected change than the position taken today by pro-market thinkers who say that "the market can provide good jobs for everyone if only we get the regulatory and tax load off the backs of entrepreneurs." This view, a central point in the libertarian and classical liberal view of what will be best for a market economy (and

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the focus of Bob Dole's 1996 presidential campaign), has no doubt been valuable right up to the present and may even continue to have considerable validity for a few years. But it is imperative to notice that it doesn't even take into account the flight of jobs to low-wage locales in the global market, much less look ahead to the rapid advance, first, of frictional displacement and eventually to the supplanting of most work. The pro-market concern about impediments to productivity can certainly produce results in the short-term as an *offset* to the longer-term secular trends, because there are a great many such impediments giving us, relatively speaking, lead feet today – but it fails to address the secular tendencies, which are hitting advanced economies at incredible speed.

In a near-workerless economy, it will no longer be possible to center personal life around work (unless, as Rifkin suggests, volunteer work, valuable but unable to command a price, comes to be a general substitute), a fact that forces a rethinking of human relations in every aspect. (It has been suggested to me that "Parkinson's Law" might come into play with people becoming "busy" with much that appears productive but is not, with this perhaps being governmentally imposed. It is difficult to know what direction things may go in any given society.) The implications, moral, social and institutional, touch upon virtually all subjects.

Second, there is an aspect that Rifkin doesn't mention. The technological revolution will not continue, but will grind to a much slower pace or even a halt, if the displacement of hundreds of millions of workers makes them unable to buy the products flowing from the hyperproductivity and if they are in a state of revolution (and perhaps of an understandable, though destructive, Luddite-like opposition to new technology) because of their plight. The market will not produce more than can be sold at a profit. There is enough demand arising out of today's world to carry the technology and displacement quite far, and Bill Gates believes this will continue for some considerable time; but, to the extent that millions of people fall out of the income stream, the problem described as "a lack of purchasing power" and "underconsumption" ceases to be a socialist pipedream and becomes a central inhibitor of further technological progress. The only way the arc of change can reach its culmination is if those hundreds of millions of people come to be included through a system of distribution to them that is not based on their

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having worked (or, at the very least, worked very much) for what they receive.

There are various ways a broad-based distribution may come about. It is possible that a market might evolve in which young people start work later and later, the elderly become an ever-larger portion of the population (as they are) and retire at ever- younger ages, the workweek is shortened dramatically, and much of the work consists of serving those who do make incomes from the computer-integrated technology or whose stock ownership in that technology gives them a flow of income. Whether that, or something adapted from it, will be the most desirable organization of the economy for a free society will be problematical, however. The criticism that a successful market involves "trickle down" from the rich to those who are less successful has been perverse in the broadly participative economy we have known, but it would be a serious criticism of an economy in which the rewards of immense productivity go to a relatively small number of highly skilled individuals and to a limited number of stockholders, leaving the income of hundreds of millions of others to depend upon the expenditures these people make for services. Under such circumstances, the further criticism that those who reap the rewards "have not truly earned them" will also carry considerable validity, since the technology won't have been the creation of those people, however skilled, but will consist more than ever of the accumulated knowledge of world science.

Of course, much of this is obviated if the broad mass of the population consists of stockholders who share in the productivity as investors. Today, many people in the United States have major holdings through their retirement savings. Anything that will increase the breadth of ownership will help provide the basis for a future market economy. Louis Kelso wrote a book a few years ago calling for an enhancement of "free enterprise" by government's giving everybody an equal share in all property, from which each person would then reap income as dividends. This was, of course, nothing more than a disguised form of socialism, giving everybody an entitlement. Although I considered his book intellectually dishonest, those who want to retain the semblance of a "market" while addressing distributive needs, and the need for a continuing demand for the products, may find themselves forced to go to some such expedient.

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Third, it will be essential quite soon for supporters of the market, who see the market (as this reviewer has) as a primary guarantor of a free society, to come to grips with the issues and to decide what is best for a free society. This will involve the question of whether they are willing to oversee the implementation of a massive reorganization of society toward "entitlements" (something they have despised because of the moral and social, and erstwhile economic, consequences; and something that, as we have just seen, can be accomplished in several different ways). If they are forced to choose this route, it will be for them to design a society in which living-through-entitlements does *not* create the state Leviathan they fear and does *not* corrupt and debase the population. If this is the direction taken, they will do well to point to a new concept: one of "Separation of Economy and State." They will want the mechanism for production and massive free distribution to be divorced from the state (which, because of its own inherent functions relating to justice and national defense, must possess a monopoly over the use of force). They will not want their adaptation to the new realities to be a selling out to socialism. To play a role, however, and even the central role, they may have to move toward ideas and policies that their outlook (which reflects the world as they have known it) has rightly recognized as socialist. With these things in mind, can we imagine what the Republican platform might well look like even so soon as 2004?

Preparing for the Twenty-First Century
Paul Kennedy
Random House, New York, 1993
Hardback, 429 pages, $14
ISBN 0-394-58443-0

Kennedy does not pursue nearly so inexorably the consequences of worker displacement, though he gives it more than a passing nod. For that, Rifkin's book is much superior. But *Preparing for the Twenty-First Century* has the merit of casting a broader net, pointing to a wide range of important secular trends. It, too, looks ahead, albeit again just a few years, to a vastly different world. Virtually all of these trends are well known to intelligent readers, and Kennedy's discussion of them tends to be conventionally

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"politically correct" and therefore deracinated and pedestrian; but there is value, especially for our purposes of putting all ten books into context, in seeing the developments enumerated together.

Here are trends he sees:

(a) *The technical revolution displacing workers.* Looking not quite so far as Rifkin, who sees *virtually everybody's* displacement, Kennedy thinks the new technology will primarily cause displacement in the lesser-developed nations. He speaks of "biotech farming" and says it "may be beneficial to a high-tech, food-importing country like Japan but potentially disastrous to developing nations like Ghana or Costa Rica that rely upon crop exports." He sees that even if African farmers, say, were to become as productive as American farmers "there would be a massive displacement of labor, with little prospect of employment by industry or services [in Africa]." As to an advanced economy such as that in the United States, Kennedy ponders "the fate of the four-fifths of Americans who are not in such international demand." Not seeing that it may ultimately be the new technology, and only temporarily the flight to low-cost foreign labor, that will produce displacement, he points to the impact of international competition and the relocation of manufacturing abroad (which are genuine concerns of the present).

(b) *The accelerating growth of world population.* Kennedy reminds us that "in the eighteenth century, the global population was adding another quarter of a billion people every seventy-five years; today, such an increase occurs every three years." In 1990, there were 5.3 billion people on earth. By 2025, there will be 8.5 billion. Some demographers expect world population eventually to stabilize at about ten or eleven billion, but some predict as high as 14.5 billion (and they can't be sure it won't go much higher). Some observers believe, hopefully, that affluent peoples tend to have fewer babies; if this proves true under the impending circumstances, it suggests that the new worldwide hyperproductivity, which is just taking hold, may create a standard of living that will bring about, through such choice, just such a lowering of birth rates, thereby mitigating the projected increases. (We must, however, entertain the opposite possibility which is that relatively affluent and yet idle millions may have more rather than few children. We simply don't know).

(c) *Mass migration of peoples.* Under pressure from the population explosion and the changing economic conditions, Kennedy

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says that "it seems unlikely that there will not be great waves of migration in the twenty-first century," a migration that he thinks is "unlikely to be deterred."

(d) *Internal ethnic changes.* Even within existing societies, not counting the flow from outside, the demographic constitution of the society points toward change. Kennedy observes that in the United States Caucasians will "become a minority" by 2050. In Russia, the Muslim population is increasing much faster than that of Russians. Russians are already less than half the population, and "the Russian share" will "fall relentlessly throughout the twenty-first century."

(e) *The supplanting of Euro-American civilization.* It is an indication of Kennedy's own deracinated "political correctness" in light of the current intellectual vogue of "multiculturalism" that he considers it merely an "interesting question" "whether 'Western values' – a liberal social culture, human rights, religious tolerance, democracy, market forces – will maintain their prevailing position in a world overwhelmingly peopled by societies which did not experience the rational scientific and liberal assumptions of the Enlightenment." This is, of course, an issue of fundamental, not merely of "interesting," importance.

(f) *The aging of the population in all advanced countries.* 16.6 million Americans, he says, were 65 or over in 1960. By 1990, it was 31 million; by 2020, it will be 52 million; and by 2030, 65.5 million.

(g) *The "revolution in world communications."* Cultures are being brought into intimate contact through "computers, computer software, satellites, fiber-optic cables" – to which today (even so soon as three or four years after he was writing) he would no doubt add the Internet (which is just the beginning form of the "information superhighway").

(h) *The globalization of business through multinational companies and world capital flows.* Many larger firms are no longer identifiable as a given country's, and webs of "out-sourcing" bring clusters of internationally diverse firms together. "The real 'logic' of the borderless world is that nobody is in control – except, perhaps, the managers of multinational corporations, whose responsibility is to their shareholders." In international finance, "vast sums...move in and out of a country or a stock according to perceptions of that entity's prospects."

(i) *Diminishing national sovereignty.* "These global changes call

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into question the usefulness of the nation-state itself." In this context, Kennedy sees it as retrogressive for "nationalist and antiforeign political movements [to] gain ground."

(j) *A widening rift between rich and poor countries.* He sees the technically advanced nations becoming ever more affluent, while poverty will stalk the less developed peoples. He points to one billion people now in poverty.

(k) Kennedy devotes a chapter to the degradation of the environment. He attributes an improvement in some aspects of this to the Green movements in advanced economies. We have reason to hope, however, that the new laboratory-computer-robot technology will do much to reverse the environmental trends (just as the city of Indianapolis, say, is a delight today compared to its smoky past).

Kennedy's own analysis of "what is to be done" is shallow and conventionally "liberal" in the twentieth century American sense of that term. On the one hand, he repeats shibboleths uncritically, such as when he says that the 1991 attempted coup by *Communists* in the USSR was "right wing". On the other hand, he does not think radically in keeping with the magnitude of the changes. Economically, he favors "industrial policy" such as has been used in Japan and East Asian countries. He says we should "brace ourselves" for the changes, but doesn't spell out what that must consist of. He is strongly internationalist, and decries any people's concern over the continuity of race or culture (this, despite the fact that he credits Japan's "social and racial coherence" as a factor in its success).

For ourselves, we can look at the trends Kennedy has identified, keeping Rifkin's "end of work" projections in mind, and see that they point in a very different direction than he prefers. What will be needed for managing the displacement, and for survival in a world of upheaval, will be *a reaffirmation by each people of its own responsibility to itself and its own.* Even in a world of intimate contact, economic nationalism will become essential (assuming that there is no world organization fitted to take up the task of production and distribution, which seems a reasonable assumption not only in terms of practicality in today's world but also in terms of what is acceptable to the world's free societies). If 70,000 vanilla farmers are to be stripped of their livelihoods on Madagascar and can find nothing else the world needs of them, they will be impelled to think the world market no longer applies to them and that Madagascar must see to

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their well-being itself, using technology for production and distribution. They will see Madagascar's great need under these circumstances as (a) a reordering of its own institutions, (b) access to technical knowledge (and to some capital, which it may or may not already have), and (c) the maintenance of order and of civilization within itself.

The "economic nationalism" to which I refer is consistent with a rich cultivation of local culture and tradition, something for which a market economy, demanding mobility and constant adaptation, has for several centuries been criticized for uprooting. Not only are the imperatives of the new technology toward economic nationalism, but a heightened world affluence will accommodate people's fashioning their lives, as cultures and as individuals, as they wish. Even if outdoor farming becomes obsolete, for example, millions may choose to live as hobbyist farmers out of sheer preference for that way of life.

It may be consistent, not at variance, with this to say that there is plenty of need for "international" policies in the form of technical information transfer and capital assistance (which will become easier for the advanced countries to provide as they unleash the new technology to its utmost). It may be in the vital interest of advanced countries such as in Europe and America to provide technical and capital assistance, not just out of fellow-feeling for billions of other human beings but because only in that way can they prevent the migratory flows that otherwise will swamp them and obliterate their existence. Whether such assistance will help stop the human migration is hard to say; the answer may need to come through experimentation. Needless to say, any such efforts will not be a substitute for a given government's carrying out its obligation to its own people to protect the country's borders.

The Road Ahead
Bill Gates (with Nathan Myhrvold and Peter Rinearson)
Viking Penguin, New York, 1995
Hardback, 286 pages, $29.95
ISBN 0-670-77289-5

Bill Gates, as everyone knows, is Chairman and Chief Executive Officer of Microsoft Corporation, of which he was a founder. *The*

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Road Ahead is both a history of computers and a look into the future of "the information superhighway." Easily readable and fascinating in its detail, it has much to commend it as required reading in colleges of business for years to come.

It is important to note that Gates' discussion, as broad and as important as it is, covers only part of the current technological revolution. It does not discuss robotization in detail, or the biotechnical revolution, or even the vast displacement of service personnel. His book expresses ebullient optimism, but cannot be taken as a total discussion.

I was delighted to see a certain comment he makes early on, because it describes well the situation of anyone who writes about a process of profound change. "This is meant to be a serious book," he says, "although ten years from now it may not appear that way. What I've said that turned out right will be considered obvious and what was wrong will be humorous." That applies, as well, to articles like the present one, which "goes out on a limb" much more than he does.

One of the main values of the book is Gates' look ahead to the immensity of the change that is coming. Before much longer, he says, people will be able to carry on many of the activities of their lives from their armchair. Monetary transactions will be handled by computer. Entire libraries will on CD-ROM (which for future readers I will explain is one of today's ways of storing information on computer). Even today's fiber-optic cable is astonishing: it "is made of glass or plastic so smooth and pure that if you looked through a wall of it 70 miles thick, you'd be able to see a candle burning on the other side." Laboratories are already working with transistors that are *10 million times faster* than those in computers now in general use. Gates looks forward to the day, not very far off, when everybody will have a wallet PC (personal computer) to serve countless purposes. Electronic books will take the place of printed books.

As to the timing of the change, he believes that the hardware will be in and everything he is talking about will be broadly available within 20 years, even though it will take longer for it to become universal. The impact won't be fully felt until various interconnections are made. The process of change will be held back, too, by the fact that many people are comfortable with what they already know. We could add that it takes time to replace the entire capital stock of the world.

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He sees the fact of frictional displacement. Some major accounting firms are already using far less office space, simply maintaining a generic office for accountants who pop in temporarily. Management hierarchies will be flattened (as is already occurring) by direct communication between top management and those performing tasks. In fact, all "middleman" professions, such as real estate agents, will have to find ways to "add value" or will be washed away. Many stores will disappear, with only those remaining that people want to patronize out of the sheer desire to shop in person. Banks and stockbrokerage houses will cease to exist physically, but will become electronic clearinghouses. Knowledge workers in all countries will compete, because of instant worldwide communications, with knowledge workers of every other country. Just the same, despite all this, Gates is found to understate the extent of displacement, such as when he says that "there will be dislocations in some business sectors that will create a need for worker retraining." Instead of seeing an urgent social necessity, he says "we've got a good number of years to observe the course of the coming revolution...."

He doesn't, however, believe there will be what I've called "ultimate displacement," which is what Rifkin predicts so strongly. "Entire professions and industries will fade. But new ones will flourish." Seeming to relate only to the development of personal computers, he says that "outside the computer industry it is also hard to find a complete business sector hurt by the PC." "Whole new markets will emerge, and a myriad new opportunities for employment will be created." He is disposed to see the computer revolution in terms similar to the automobile's having taken the place of the horse: one vast industry replacing a more primitive one. At no time does Gates discuss the tendency of computers, biotech and robotization radically *to reduce, as to all tasks, the sum of human effort needed.* This means that he never considers, either, the fact that there are billions of people on this earth who lack the intelligence ever to become employable among the "knowledge workers."

The Competitive Advantage of Nations
Michael E. Porter
The Free Press, New York, 1990
Hardback, 855 pages, $37.50
ISBN 0-02-925361-6

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The preceding books have stated some of the outer reaches of impending change. That allows us to understand the scope of the challenges (subject to the fact that there is much more to be said). Now it will be helpful to take the other seven books in the order that seems most natural, which is to consider them in the order of their awareness of the change, starting with the one that seems least aware and working back toward Rifkin, Kennedy and Gates. I will evaluate them in light of the extent of their meeting the new exigencies (but this perspective must be understood as tentative on my part until I have finished my study.)

Porter, who served on President Reagan's Commission on Industrial Competitiveness and has conducted a four-year study of ten major trading nations, will no doubt be surprised that I consider *The Competitive Advantage of Nations* as the least aware. His book is emphatic about the need to be on the cutting edge, and this gives every impression of his being ahead of the curve. This impression would be correct if the issue were simply "how can a nation's firms keep up in today's global market?"

He addresses that issue energetically by embracing a full free-trade position in which he sees the competitive rivalry of firms that shift constantly to higher-productivity niches, with either ever-lower costs or differentiated products, as the key. Successful competition in the world market, he says, must be based on quality, rapid product development, and advanced features other than price. Hardly anyone has a meaningful "comparative advantage" anymore, when compared to the need to keep running to stay at least a half-stride ahead. The point is to hold a lead by constant innovation. Government can help by providing information, education and training, but otherwise governmental intervention, including protectionism and redistribution, will lessen innovation and the needed rivalry. Anti-trust policy should insist on sharply competitive markets, assuring vigorous domestic rivalry; and firms are even aided in their cutting-edge competitiveness by laws in their home country that set high standards, such as on environmental impact, that other countries will eventually find it necessary to demand of their own firms. The book includes a number of policy suggestions, such as regarding taxation, that would help competitiveness. In all, Porter's is an excellent book for businesses competing in today's market and for its statement of an outlook that will allow them to compete.

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The supreme weakness is that all of this says nothing about an economic system as a means of mass participation and mass wealth-creation. It speaks in a rarefied atmosphere of always-higher skill and quality. It makes no effort to define a role for the average fellow with a high school education and two years of college. Porter never considers displacement, either that comes from low-paid foreign workers or that will very soon come from near-workerless technology. Speaking passingly of social legislation that seeks to address workers' needs, he argues that "such restrictions erode the underpinnings of sustained national advantage" and says that "*other and better approaches must be found to address the social concerns that such policies reflect.*" He leaves it at that, not making it his business to think about the whole universe that those "social concerns" entail. His emphasis is on the firm and what a nation must do to provide the milieu for success on the part of its firms; this does not involve him in making an effort to see an economy as an economic and social system serving many millions of people.

Ordinarily, this would be no basis for criticism. An author may write about a selected slice of life if he wishes. But in the present context, his emphasis misses the point of the changing economic reality. Accordingly, the book's 855 pages have very little to tell us. Porter is one author who is not a socialist, and his thinking fits splendidly into that of free-market theorists of this reviewer's own persuasion. With them, he faces the prospect of suffering profound disrepute very rapidly if he doesn't do some radical rethinking to meet the fact of worker displacement.

Manufacturing Matters: The Myth of the Post-Industrial Economy
Stephen S. Cohen and John Zysman
Basic Books, Inc., New York, 1987
Hardback, 297 pages, $9.95
ISBN 0-465-04384-4

The sub-title speaking of "the myth" of a "post-industrial economy" is talking about something other than a near-workerless economy, so we run the risk here of some confusion of language. By "post-industrial," Cohen and Zysman mean an economy centered heavily on services as distinct from manufacturing. They point to the dramatic move that has occurred in the United States from industry

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into the service sector. "The data show a relentless decline in manufacturing employment, from about 50 percent of all jobs in 1950 down to about 20 percent now, and an irresistible increase in service jobs, up to about 70 percent of all jobs." They add that "since 1973 manufacturing has not added any jobs at all."

In response to this decline, they argue that "manufacturing matters" and that, for the nation's well-being, there must be a "national agreement" for a re-emphasis on manufacturing. They see manufacturing as the ultimate source of high technology, of military capability, and even of the health of the service sector. Their concern is broader than Porter's, since they focus on the economy as a whole, not just cutting-edge firms. We notice, too, that they do not see, or perhaps simply are not convinced by, the prospect of vast displacement either by low-cost foreign labor or workerless technology. (It is not apparent to this reviewer why they do not see ahead to massive worker displacement, since, as we will see, they urge the United States' industrial salvation as coming from high-skilled automation.) In their opinion, if the United States develops a new consensus about the importance of manufacturing and implements a series of policies to undergird manufacturing competitiveness, the country will be back on a tenable footing.

A number of elements go into Cohen and Zysman's suggested policy of industrial competitiveness. Comparing the United States with its competitors, they speak of the United States' "radical inability, relative to them, to apply high technology to the production of traditional goods and to maintain our competitive position by diffusing technology and know-how widely throughout the manufacturing economy." The convergence of computers and telecommunications should be creating a new infrastructure for industry; and Cohen and Zysman are concerned that in the United States, unlike in Japan where it is a matter of conscious policy rather than market dynamics, this infrastructure is developing primarily to meet the needs of large firms. Just the same, despite the breadth of their concern, they say that if the United States is to maintain the high wages its people expect, it will have to center its efforts on "high value added" products. Regretfully, "there are no automatic or clear-cut answers to where high value added is to be found." They envision industry's moving to "a fully integrated system linking design to manufacturing, permitting an automatic shift from one product to the

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next," a system called "computer integrated manufacturing (CIM)." What will be decisive will be "the development of manufacturing skills based on the introduction of programmable automation and skilled labor."

To help with all this, government, they say, has several things it can do, although they oppose a strategy of state-led development. Government can stimulate research into generic applied science, providing technical information to industry; and "it can upgrade the quality of what goes into production, the factors of production – raw materials, capital, labor – and the networks and rules that affect how those factors are combined." Moreover, its policies can greatly affect the level of saving and can even lead to an opening of international capital flows (which they see as presently somewhat closed into the United States) so that it won't make any difference where the capital comes from.

They oppose what they call "defensive trade protection," thinking that American firms would thus be made less innovative and competitive. But the United States, they say, shouldn't open American markets to others without reciprocity.

If we place Cohen and Zysman's book along the "curve of change," we see that their horizons are short. They call for the automated economy without grappling with its implications.

The Myth of Free Trade: The Pooring of America
Ravi Batra
Touchstone Books, New York, 1993
Paperback, 274 pages, $12
ISBN 0-684-83355-7

Batra agrees with Cohen and Zysman that manufacturing is the key to a people's prosperity, since it pays much higher wages than other sectors. And in this connection he believes that a disaster has befallen the United States. Citing Bluestone and Harrison's phrase "the deindustrialization of America," he points to the fact that industry now employs only 17 percent of the workforce. "Since the 1970s, cheap imports produced by foreign workers, sometimes laboring on pennies per day, have destroyed and even exterminated industry after industry in the United States." American firms have responded by shifting high-wage manufacturing jobs abroad so that

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they, too, can produce cheaply. He tells us how, even prior to the North American Free Trade Agreement (NAFTA), 1800 industrial plants had since 1965 relocated to Mexico. Those firms might well prosper, but American jobs would be lost and wages would fall.

While economic indicators such as GNP have continued to go up, the best indicator of well-being, he argues, is inflation-adjusted average weekly earnings for non-supervisory personnel, a statistic that tells how the average person is doing. This is a better measure than per capita income or average family income, mainly because these fail to take into account the movement of millions of women into the workforce, a movement that has masked the decline in prosperity.

Those who have lost jobs in industry have shifted to the much lower-wage service sector, and this means Americans have experienced an overall loss of personal income.

Why have these things occurred? Here, Batra proves ambivalent. The first two-thirds of his book ascribes it, as just stated, to low-wage foreign competition. He tells how, with agriculture, productivity kept going up historically but the inelasticity of demand meant that the return to the farmer, for each unit of production, became ever lower. The same thing has happened to American industry (and to that of other major industrial countries), not because of inelasticity of demand, but because competition from low-cost foreign goods caused a low "industrial relative price." This, he says, has been happening ever since the United States ceased in the 1970s being a closed economy and shifted to a high ratio of international trade.

What seems a coherent explanation of the falling wages becomes confused, however, when Batra's argument later shifts to emphasizing that American industry is highly concentrated and that "monopolies" aren't very good about sharing their earnings with their workers. One is tempted to rationalize these two explanations by thinking that Batra believes them both to be operating simultaneously, but this is belied by the fact that he eventually recommends a high tariff level (40 percent) for industry where the firms have been concentrated, but no protection at all for industries where small-firm competition has prevailed. If undercutting by low-cost foreign labor were to him the crux of the matter, the low-price foreign competition would defeat the less concentrated American industries right along with the others, and they would need

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protection, too.

One gets the impression that Batra migrated intellectually as he wrote the book, and that he went from quite a sound body of analysis (about foreign competition lowering the relative price of industrial goods) to one that was willing simply to invoke whatever arguments would support his thesis. His proposed policy is that the United States should go to "competitive protectionism" – the breaking up of large firms to allow a sharply competitive domestic market behind a high tariff wall. The "monopolists don't pay well" argument seems to have been added as extra support for the view that large firms should undergo divestiture. My impression along these lines is reenforced by the fact that Batra concludes his book with an element he hardly considers until the end: that international trade is destructive because the transport of goods involves the use of large amounts of energy, which is bad because energy-use is the main polluter of the environment. If he had rewritten the book to integrate these points, their relationship might have seemed harmonious. As it is, we have been enabled to gain the insight that one thing is simply stuck onto another.

To weigh the significance of his book, it is best to give him the benefit of his main analysis, which is quite impressive. This is the part that looks to the impact of foreign competition and calls for protectionism, but of an internally-competitive type. He skewers effectively the clichés of the laissez-faire free trade school (now reigning supreme in American ideology both Right and Left). Those cliches have always been simplistic, but their shallowness hasn't until recently caused the United States much harm (mainly because they were ignored during much of American history as the United States followed a protectionist policy). One of these is that trade is made up of contractual relations in which both parties necessarily see themselves as benefitted (otherwise, they wouldn't enter into any given transaction), with the effect that in buying foreign products Americans are seeing their welfare served as consumers. The fallacy in this, Batra observes, is that "it assumes that consumers are different from workers, so that while workers suffer, at least consumers benefit." The preoccupation with consumers ignores the duality that "what matters is not just prices but wages as well." And "80 percent of Americans have seen a dramatic drop in their earnings." Another of the cliches is that, pursuant to the doctrine of

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"comparative cost," each country will be better off from producing what it produces best, trading for the remainder. Batra, in response, notes that "this logic does not even depend on what wage rates prevail in various nations." A country might produce more, as the United States has, because of the division of labor that international trade brings about, but the overall wages paid to its workers may fall. "Free trade may have helped Americans produce more per hour, but because of falling world demand for their products they are earning less than their 1973 salaries, and some even less than their 1950 salaries." The reason that "U.S. economists have failed to see the depredations of free trade" is that "they focus only on productivity and ignore earnings." Batra's observations are in line with this reviewer's own thinking over the years that the "theory of the transaction" contained in standard market analysis has been incredibly shallow, almost certainly out of a desire by neo-classical economists to serve ideological purposes in a much-needed defense of a market economy against its many opponents.[4]

Batra believes that a protectionism that allows internal monopolies to become fat and lazy is a terrible policy, but that one that assures a market to a large number of hotly-competing firms in the domestic market has much to commend it. He would cut the import share of the American economy more than in half by raising tariffs from the present average of about 5 percent to 40 percent (although, oddly, not on goods where the domestic firms have not been concentrated). It makes no difference whether firms within the United States are funded by American or foreign capital, since what counts is their employment of American workers (a view that underscores his focus on wages as a source of income for Americans, which here becomes a preoccupation that makes him forget the importance of income-flow to investors and lenders as a way to distribute the productivity to many people). In comparison with his "competitive protectionism," Batra sees "industrial policy," where government picks winners and losers and then sponsors firms in

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[4] See this reviewer's analysis of the socialist theories of exploitation in *The Journal of Social, Political and Economic Studies* (reprinting a chapter from his book *Socialist Thought*), Spring 1996 issue, pp. 77-100. Much of that analysis involves getting into considerably greater sophistication about the nature of a voluntary transaction in the labor market.

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international competition, as "an impotent response" because it doesn't address the drop in the industrial relative price.

Our critique? A "competitive protectionist" policy in response to a secular fall in American wages places Batra's analysis much further "along the curve," to continue the metaphor I have been using, than Porter's or Cohen and Zysman's. It has the advantage of shifting attention to the need for economic nationalism, reducing the role of international trade, under current and impending conditions. Nevertheless, it fails to come to grips with the phenomenon of technological displacement. The protectionism may be a valuable intermediate step, but the breaking up of firms may simply add much distress without arriving at an economy best suited to meet the needs flowing from the displacement of work. In addition, some products such as aircraft require massive capital investment and large firms.

The Political Economy of Industrial Policy
Ha-Joon Chang
St. Martin's Press, New York, 1994
Hardback, 184 pages, $65
ISBN 0-312-10294-1

Chang arrives at a policy of "competitive protection" by analyzing the mostly-successful "industrial policy" of South Korea. Under the influence of such thinkers as List, Schumpeter and Marx rather than of free market economists, the government there has since the early 1960s been actively involved in managing the economy, seeking to build an "independent economy" that will create an acceptable standard of living for South Koreans. Effort has been shifted from agriculture to industry, and within the latter to heavy industry. Prices have been set by law; there has been controlled entry into, and capacity of, firms within given industries; consumption has been repressed to provide saving; foreign majority ownership has been banned, except in free trade zones; quality has been closely monitored; and tariffs have been kept low on raw materials. While such interventionist policies could create a deadly sluggishness, what has made South Korea's industrial policy successful has been the willingness of government to "withdraw support whenever performance lagged." Chang sees the advantage of "industrial policy"

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over central planning as being that the former uses the profit motive, which he sees as the key to innovation.

Chang does not undertake to analyze world trends or to address the issue of technological displacement. His book does point, however, to the fact that South Korea's recent success has centered on its own self-regarding sense of what has been necessary for itself. In a world founded on the new realities, South Korea will have a far less wide-reaching adaptation to make than will economies whose opinion-makers have foresworn economic nationalism and have embraced as unquestionable the concepts of laissez-faire global competition.

Postindustrial Possibilities: A Critique of Economic Discourse
Fred Block
University of California Press, Berkeley, 1990
Paperback, 227 pages, $15
ISBN 0-520-06988-9

Block's book is based on research done during the 1986-7 academic year, and hence is a decade old. Just the same, he was able to foresee much of the 1990s' radical economic change, except that he did not foresee, as Rifkin does, the impending cuts in the number of workers needed in the service economy, which Block relies upon to absorb those who have been displaced from agriculture and industry. With that ingredient missing, Block is essentially grappling with the traditional economic and social issues. He is a socialist of the nineteenth century decentralist school, adopting the frame of reference of the Left on a number of conceptual issues and referring frequently to such thinkers as Marx, Comte and Jencks. He points toward "the democratization of work" and a guaranteed minimum income. For a non-socialist or even anti-socialist, his book would seem like "more of the same," *unless* it is correct to think that there is an impending disappearance of work and this forces us all to consider a national economy from a pooling standpoint.

What were the changes he foresaw? "As technology displaces human labor..., the size of the factory labor force shrinks ... and computerization can also reduce the amount of labor devoted to process-control operations." Although the use of robots was already far advanced, Block foresaw that, with greater capital investment,

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industry could go, as the Japanese already had in many areas, to "flexible manufacturing systems," where the entire manufacturing process is "under the control of a central computer." In clerical tasks, he looked ahead to "trends in office automation" and the elimination of data-entry personnel by "more sophisticated data-entry systems" such as the optical scanner. The movement toward temporary workers and part-time employment was already apparent. Despite these factors, he thought "service-sector employment seems likely to continue to expand."

Addressing the issue of employment, Block says "the most basic prerequisite is...[individuals' development of] their intellectual skills." By way of criticism, we can't help but notice that gearing up to be "knowledge workers" cannot fit an entire population, in which the *median* I.Q. is 100, not 130.

This fails to take into consideration large numbers of people's needs, even without taking into account Rifkin's projection that work will tend to vanish in the service sector. But if such a diminution occurs, there will be a lot of educated, highly skilled people, who relied on his (and others' such as Robert Reich's) advice about what to do to prepare themselves, with little income-producing potential. Perhaps Block feels, from his own point of view, that his call for an increased government provision of collective goods (not through a central mechanism but through multiple centers and through business firms that have been made instruments of public purpose) already anticipates the response that is needed, so that it doesn't matter greatly whether, from ten years back, he foresaw as much as might be foreseeable today.

Postindustrial Possibilities, then, was fairly far advanced in anticipating the curve of change. Its prescription of "more training" makes sense in the short term, but isn't adequate ultimately. Neither is his call for "workplace democracy," since that may quickly become outdated if a near-workless society eventuates. He sees the failure of centralized socialism, however, and is not a totalitarian. We can well imagine that, from the Left, he will have something to contribute to the dialogue that must now begin to include conservatives and classical liberals.

Before we leave him, it is worth mentioning that he points to some important insufficiencies in much economic data as it is compiled today. Capital accounting, he says, becomes problematical

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when it doesn't take into consideration such things as organizational factors, the money spent on human capital, and such "intangible expenditures" as spending on research. If capital is valued at its original cost, "there has to be some kind of adjustment for changes in price levels and procedures for assessing the value of older capital relative to newer capital in light of technological advances." An example that comes to my mind is that I paid $2600 for a computer in the early 1980s and another $2600 in 1996. The price was the same, but the one in 1996 is immeasurably better. This is the phenomenon that Block calls "capital savings." The increase in productivity and well-being is there, but doesn't show up in statistics measured in dollars.

Another statistic he questions is that of GNP, which no longer tells us much about the economy: it doesn't show capital saving, how property or income is distributed, impacts on the environment or on life expectancy, work done at home, the value of leisure, and such "externalities" as peoples' sense of economic security or insecurity. These criticisms show that an assessment of relative economic well-being requires more than accepting customary data at face value. In addition, it will be important to look at a number of elements and to be wary of arguments based on selected factors.

The Work of Nations:
Preparing Ourselves for 21st Century Capitalism
Robert B. Reich
Vintage Books, New York, 1992
Paperback, 340 pages, $12
ISBN 0-679-73615-8

Reich has much in common with Block, in that *The Work of Nations* is strong on what has happened and will be happening economically, but makes policy suggestions that bear little relation to the problems. He, too, stresses skills training as though that will fit the needs of the great mass of the population. More than any of the other books discussed here, Reich emphasizes how business firms are losing their national identity. "There will be no national products or technologies, no national corporations, no national industries." The reality is that "the core corporation is no longer even American. It is, increasingly, a facade, behind which teems an array of

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decentralized groups and subgroups continuously contracting with similarly diffuse working units all over the world." Capital flows to whoever can make something at the least cost. And "foreigners are coming to own an ever greater proportion of America's productive assets," while "American corporations are investing abroad at a furious pace." It is a global market, with global firms and a global workforce. His analysis is valuable makes us think twice about references to a nation's "firms" or "industries" or even "economy." Without looking underneath to the reality, nothing is certain to be what it seems.

Reich reenforces the other authors in pointing to a major impact on jobs in the United States. He says the top 500 industrial firms "failed to add any American jobs between 1975 and 1990." As factories became automated, jobs disappeared (in steelmaking, for example, through a reduction from 480,000 to 260,000 employees between 1974 and 1988). Lower- and middle-management production jobs were cut back sharply: "Between 1981 and 1986, more than 780,000 foremen, supervisors, and section chiefs lost their jobs through plant closings and layoffs."

He classifies workers today into three categories: "routine producers," "symbolic analysts," and "in-person servers." The routine producers are directly in competition both with robotization and low-paid workers all over the world, with nothing to insulate them. Their employment will continue to decline. Those who run the robots are well paid, but only a few people are needed for that. Reich considers even data processors and computer programmers as among the "routine producers." In data processing, wages have been depressed and jobs have evaporated, since it can be done much more cheaply in, say, the Philippines or the Dominican Republic. Computer programmers are in competition with programmers in Bangalore and everywhere else.

The symbolic analysts (Block's "knowledge workers") constitute about 15 to 20 percent of the workforce. They have thrived and have for the most part received high compensation, working in high-skill areas such as science and research and design engineering. There is a worldwide market for their services as communications and transportation have improved. But even here the exposure to competition from the over-five-billion people around the world is making their situation precarious. "The worldwide supply of symbolic

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analysts is growing ... Millions of people across the globe are trying to learn symbolic-analytic skills." Reich believes Americans will keep the advantage for this type of worker because of the United States' system of higher education and the critical-mass of symbolic workers already present. An "advantage," though, doesn't mean that compensation won't be undercut or that as many will be employed. It's worth remembering in any case that we're not talking about mass employment at high wages when we're discussing "symbolic analysts." Many of their jobs are threatened by computerization, as much engineering, design, artwork and other mindwork comes to be done electronically.

Since "routine producers" are in "a sinking boat" and "symbolic analysts" make up a small fraction of the public, millions of people are flooding into the "in-person server" category, becoming such things as aerobic instructors and nurses' aides. But the income of even this group "is sinking as well, but somewhat more slowly and unevenly." The supply of people seeking such work is so great that wages are sent downward, in keeping with what Batra tells us about wages in the service sector. Moreover, as technology advances, "the fiercest competition that in-person servers face comes from labor-saving machinery...automated tellers, computerized cashiers, automatic car washes, robotized vending machines, self-service gasoline pumps...." Keep in mind that we are talking about the great bulk of the public here.

What does Reich propose? He is an "economic nationalist" only in a limited sense. He wants government to spend on a number of things such as infrastructure, childcare, education, and job training; but he also wants no barriers to free trade. Foreign ownership of business is all right, provided the nation's citizens are employed in skill-enhancing functions. There should be subsidies to firms, foreign or domestic, that undertake to train or provide skilled job experience to American employees. Taxation should become more redistributionist. And the advanced countries should make a *worldwide* redistribution of wealth, although this bombshell [because of the enormity of the task] is brought in only passingly and without Reich's even discussing its implications. He looks askance at a federalist decentralization, since redistribution is best accomplished through central power.

But Reich's paramount emphasis is on the need for people to

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gain skills, retool, retrain and stay mobile. With Porter, he stresses the need to remain at least a half a stride ahead of foreign competitors, moving to ever higher levels of technical skill mainly in areas of customized services that can't be quickly replicated by others in the world market. Again, we see proposals that fail to address the question of how to employ millions of people. Oddly, however, Reich voices at least guarded optimism about putting the poor to work through remedial courses and job training, as though there were no problem about what work awaits them. (The same doubts must be applied to the welfare reform passed by Congress and signed by the president in the United States in August 1996, since that reform is geared toward work. The measure is an excellent example of a policy that is most welcome in terms of society as we have known it, but that is rapidly being made obsolete by the changing realities.)

The Work of Nations, then, is yet another of the books that see part of the problems but are primarily rooted in things as they are (or still seem to be). The longer-term situation is not thought out adequately.

A Restatement of Economic Liberalism
Samuel Brittan
Humanities Press International, Atlantic Highlands, NJ, 1988
Hardback, 346 pages, $39.95
ISBN 0-391-03577-0

Brittan's book is an ideological anomaly: it invokes a certain theme in classical liberal thought to arrive at suggested policies that virtually all classical liberals would abhor, but which, as a classical liberal myself, I have said might need to be resorted to because of the impending near-workerless economy. He makes these suggestions, which are traditionally socialist, not because he sees them forced by the new realities but because he desires them for their own sake. Influenced by classical liberalism, though, he would seek to tie the socialist mechanism down so that it cannot become a Leviathan crushing individual liberty. Hence, for reasons related to but very different from my own, he arrives at a point that all classical liberals may be forced to consider seriously.

The policies he favors include:

1. A guaranteed income, which he calls a "social dividend,"

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that would go to everyone "whether at work or not." He would keep this significantly lower than the average wage, though, so as not to dull incentive. (This reflects his not taking the new economic realities into account as the reason for his position.)

2. As with the nineteenth century American socialist author Edward Bellamy, he would give some goods away free, although at a later point he expresses a preference for making the distribution in cash.

3. Or, he says, a guaranteed income could be devised by redistributing corporate stock to everyone, thereby enabling them to receive dividends. I mentioned this earlier and related it to the socialist author Louis Kelso (who years ago attempted to sell it as a form of free enterprise).

4. Or he would welcome the growth of employee ownership of business, which would accomplish the old Guild Socialist objective. He sees, however, that the lack of diversification involved in this makes it a precarious form of investment for any given employee (a problem that could easily be overcome if the failure of a firm were made up for by payments of entitlements to the employees, which would make sense because we are talking about a redistributionist context anyway).

5. He favors more leisure even if it means fewer material goods (which it wouldn't in an end-of-work, hyperproductivity scenario). The decrying of material desires resonates with much socialist thought.

6. Communes such as the Israeli kibbutzim seem desirable to him.

7. He favors taxing land rents, but doesn't mention Henry George (a classical liberal who nevertheless adopted some views that were shared more by socialists than by most other classical liberals) as the most famous exponent of the idea.

8. He debunks national sovereignty as a myth.

To understand how all this is made consistent with classical liberalism (which is the type of "liberalism" he is referring to in the book's title), it is necessary to understand a quirk in Friedrich Hayek's book *The Constitution of Liberty*. Hayek, of course, was a prominent member of the neo-classical Austrian School of Economics

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during the twentieth century and a leading theoretician of classical liberalism. In the book just mentioned, Hayek explained that classical liberalism centers on reducing coercion as much as possible (and in this he coincided with a concept that is central in at least one important formulation of classical liberal theory, including my own). But Hayek also went into detail about the "Rule of Law" concept, which goes back to the Athenians and sets criteria for law to meet so that the state will be tied down and rendered unable to act arbitrarily. Those criteria are that legal norms be set in advance, be clear, be known, be general, be equal in their application, and be applied by an impartial tribunal. Oddly, Hayek went off on a tangent of making these Rule of Law criteria the *sole* basis for judging the legitimacy of state action. This has been objectionable to other classical liberals because a given culture could exercise totally unacceptable coercion (as they see it) consistently with the criteria. For example, Calvin's Geneva could have a law that anyone who didn't embrace Calvinism would burn at the stake. That would meet the Rule of Law criteria but would profoundly violate the reduce-coercion rationale that classical liberals generally endorse. Along the same lines, it is apparent that much that is socialist could meet the criteria. It's odd that Hayek didn't see this, since it was he who argued in *The Road to Serfdom* that even democratic socialism leads on to totalitarianism (a persuasive, if questionable, use of hyperbole). I should add that the Rule of Law *is* a valuable *part* of classical liberalism's striving to place constraints on the power of the state. The issue is whether such procedural criteria as it embodies are sufficient *in themselves.*

Brittan wants to limit the discretion of government in following the suggested economic pooling, and favors actions that fit the Rule of Law criteria. He adds to this the classical liberal preference for decentralization, believing that freedom is enhanced if "there are not merely a multiplicity of firms within the capitalist sector [which he would see no reason to discontinue], but a multiplicity of forms of ownership – large private corporations, state-owned enterprises, one-man firms, producer and consumer cooperatives, and so on." And he would use the price mechanism as an impersonal way of directing economic behavior wherever possible. Brittan has not thought of the concept of "Separation of Economy and State" that I suggested earlier, but such a separation would seem compatible with his simultaneous effort to have much collective pooling while at the same

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time building in protections against the horrors that classical liberals identify with socialism.

Thus, *A Restatement of Economic Liberalism* finds itself coincidentally quite relevant as a discussion of how a guaranteed income in a near-workerless economy can be made, hopefully, compatible with classical liberal desiderata. In the absence of vast worker displacement, his suggestions can be taken as gratuitously socialist, and supporters of a market economy will want to dismiss them out of hand. But in the context of the impending economic realities, they are to be taken seriously.

Conclusion

These ten books merely scratch the surface of a growing literature, but they point the way toward subjects that will command ever-increasing attention.

There will clearly be vast *frictional* displacement of workers, causing immense social problems at the very same time as humanity is regaled with goods and services on a scale it has never before dreamed of. Whether there will be *ultimate* displacement to a "near-workerless economy" is a matter of some speculation and there seems no way to resolve the question in advance of seeing what happens. The normal free-market view is that "great new things will come along, as they always have, and people will be occupied in ways we can't now imagine." We can have no doubt but that great new things *will* come along, if nothing disturbs the flow of events; that part of it is clear; but whether those things will involve the employment of hundreds of millions of people is not nearly so clear in light of the fact that those things will themselves be able to be done by electronics or in the laboratory with only a minimal use of human effort.

In any case, all conservative, classical liberal and libertarian thought is profoundly challenged. A failure to consider these issues, and to do so quickly, will make their adherents' thinking obsolete at best, and hateful to much of the world at worst. Such a failure is *not* what will best serve the values, principles and institutions they revere, even though the rethinking will lead them into areas they have despised. Accordingly, one of the issues that needs to be pondered in the new context is precisely, "What really constitutes the truest form of loyalty to conservatism, classical liberalism or libertarianism?"

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Foreign Direct Investment in Developing Countries

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Foreign direct investment (FDI) is playing a growing role in economic development. FDI flows to the developing world quadrupled from an annual average of $12.6 billion in 1980-85 to $51.8 billion in 1992-93, and rose to $70 billion in 1994. Developing countries received 32 percent of total world FDI during 1992-94, up from 20 percent in the first half of the 1980s. The share of FDI in the gross capital formation of developing countries more than doubled between 1986 and 1992, surpassing 6 percent in 1993.

While FDI is surging, other forms of capital flows to developing countries are diminishing (see table). Aid has continuously declined as a share of capital inflows since the 1960s, when it was the most important source of external finance for developing countries; it now accounts for only one fourth of their capital inflows. Commercial loans, a major source of capital flows in the 1970s, have virtually disappeared since the debt crisis of the 1980s. Portfolio investment, which boomed when stock markets in developing countries caught the attention of investors in the 1980s, is important but is also volatile and risky – as demonstrated by outflows from Mexico in December 1994.

Unlike other forms of capital inflows, FDI almost always brings additional resources – technology, management know-how, and access to export markets – that are desperately needed in developing countries. Investors are exacting, however, when it comes to deciding which countries are the most desirable sites for investment, and the lion's share of FDI has been going to a handful of countries, mostly in East Asia and Latin America. In 1994, 11 countries accounted for about 76 percent of total FDI flows to the developing world. Nevertheless, some countries (including many island countries) have received amounts of FDI that are large in proportion to the size of their economies. But FDI flows to many other countries, particularly in sub-Saharan Africa, have stagnated.

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Why East Asia and Latin America?

More and more developing countries reduced barriers to FDI and improved business climates. At the same time, multinational corporations are responding to increased competition by considering a broader range of locations for their facilities. These mutually reinforcing trends have combined with technological changes in communication, transportation, and production to make "the global marketplace" a reality for investment decisions. The days of producing shoddy high-cost products for sale in local markets are passing; most foreign investors are interested only in sites where they can produce to international standards of quality and price.

This globalization means that the old distinction between export-oriented production and production destined for the local market is weakening and even disappearing. Countries that want to develop must offer good business conditions both for exporters and for production for local markets. The emphasis may differ, depending mainly on the size of the local market, but providing the combination is increasingly important. Countries in East Asia and Latin America have received the most FDI because they have adjusted their strategies to keep up with globalization.

Some of these countries initially based their development on exporting labor-intensive manufactured goods to the industrial countries. Recently, many have recognized that technological advances and intensified competition have increased the capital and skill intensity of production in many industries. This means that countries can no longer count on low labor costs alone but also need high quality, productive labor to sustain their comparative advantages. Those that have succeeded in attracting FDI have focused on improving general education, industrial skill training, and labor and managerial discipline. Facilitating companies' efforts to upgrade technology has also been crucial in maintaining their competitive edge.

The development of other successful countries was initially based on import-substituting industrialization. This strategy produced valuable skills, institutions, and physical infrastructure, but was inherently limited because of small domestic markets and the inefficiencies caused by continuing protection. These countries were either forced by economic crises or inspired by countries that succeeded through more outward-looking policies to reduce

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protection, privatize state enterprises, and make their productive apparatus competitive internationally.

Whatever route they took, the rapid, sustained economic growth of the successful countries of East Asia and Latin America has earned them the name "emerging markets." They are even beginning to rival the industrial countries as export markets because of strong, consistent increases in the demand for consumer goods and services. All this has made them extremely attractive to international investors.

Companies interested in establishing facilities in emerging markets need access to quality supplies of parts, components, and supporting services. For manufacturing industries, especially, a major force driving success is a "flexible" system of intercorporate relations under which companies specialize in different stages of production, either upstream or downstream in a production chain, and cooperate closely with each other through networking and long-term buyer-supplier relationships. This type of system helps integrate foreign investment into host economies and allows the latter to derive more benefit from FDI through induced economic activities, the transfer of technology and management skills, and better access to export markets. But companies need great flexibility and highly developed skills to ensure "just-in-time" delivery of quality intermediate goods and services, without defects. Countries that have the conditions that facilitate these kinds of operations have become much more competitive in the eyes of foreign investors.

None of the countries that have attracted significant FDI inflows could have done so without sustained trade reform enabling them to keep up with the pressure of international competition. All have carried out substantial domestic economic reforms to encourage private sector development. Many have essentially succeeded in stabilizing the macroeconomic environment, reducing price distortions, deregulating investment procedures, and increasing general economic efficiency – getting the fundamentals right for private investment, domestic and foreign.

What about Other Countries?

Many other developing countries have also embarked on reforms, addressing the same issues – fiscal and monetary imbalances, price distortions, bloated public enterprises, and unnecessary regulations, among others. Many have made significant progress,

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earning deserved praise from economists, banks, and international institutions, including the World Bank and the IMF. But FDI has either not appeared or, if it has, still falls short of the amount desired. Why is this?

One basic problem is that some countries possess few attractions for foreign investors. One traditional attraction of developing countries – cheap labor – is becoming less important in investment decisions. Economies at an early stage of industrialization do not offer the sophisticated providers of inputs – both goods and business services that most foreign investors need to be competitive. Another factor that deters investment is poor economic performance – FDI tends to follow growth, not to lead it.

A closer look at the less successful countries, however, reveals that many that are potentially attractive to FDI simply have not carried their reforms far enough. Foreign investors do not come just because some progress has been made; to attract FDI, countries must have made enough progress to meet worldwide best-practice standards.

Obstacles to Entry

Many countries have liberalized entry policies over the past few years. They have relaxed restrictions on foreign ownership and entry in certain sectors, and they have also introduced "negative lists" to limit the types of investments that require screening and approval. In many countries, however, entry is arbitrarily regulated – often from regulatory authorities with vested interests in screening.

Inadequate Legal Protection

Most governments have recognized the need for investment protection, and many have guaranteed equal treatment for foreign and national investments. An increasing number of countries have enacted laws forbidding expropriation or guaranteeing prompt and adequate compensation in the event of expropriation. In more and more countries, foreign investors have recourse to international arbitration for settling investment disputes.

Legal reforms are still far from adequate in most countries, however. In many cases, laws still implicitly allow expropriation of investors' property for arbitrary reasons. The very poor functioning of judicial systems in many countries calls into question the "prompt

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and adequate compensation" promised by law. Finally, investors are often required to exhaust domestic means for settling disputes before resorting to international arbitration. In the context of a weak domestic court system, this dramatically weakens investors' confidence.

Currency Overvaluation and Restricted Access to Hard Currencies

Since the late 1980s, a growing number of developing countries have taken steps to liberalize their foreign exchange systems. Many have devalued their currencies, and some have allowed market determination of the exchange rate. In spite of considerable adjustments, however, many currencies are still overvalued, and extensive controls on exchange transactions are still seen as necessary. Moreover, foreign exchange liberalization in many countries has been accomplished by decree but not followed up by appropriate legislative steps, creating an atmosphere of uncertainty for investors.

Trade Barriers

In the past, many developing countries that had adopted an import substitution strategy attracted FDI by offering investors a protected domestic market. Recognizing the importance of competing in global markets, most have now reduced protection. In too many instances, however, trade reforms have still not gone far enough. There is also a widespread problem in the developing world with customs services. Better trade policies may be negated by bureaucratic customs procedures. Thus, imported capital equipment and other inputs do not arrive at production sites on time; drawback payments due to exporters are delayed for months or even years; and going through the multilayered clearance process is very costly.

Tax Distortions

To attract foreign investment, some countries use special investment incentives, including tax holidays, tax credits and exemptions, and reduction of duties. However, experience shows that such strategies have had little, if any, impact on most long-term investors. Tax holidays create distortions of tax regimes; they favor new investors and discriminate against existing ones – in some countries, they discriminate against domestic investors. The expiration of tax holidays causes sudden increases in tax burdens on companies.

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Moreover, these incentives are often granted through complex and bureaucratic administrative procedures that encourage corruption. A stable, automatic tax system with reasonable rates and without discretionary incentives is better both for investors and for the host country. Many countries have a long way to go to reach that goal.

Investment Promotion

Investment promotion – persuading investors to come – has become widespread in recent years. Providing effective assistance to interested investors and businesslike follow-up, and helping existing investors to solve administrative problems are important parts of promotion that are too often neglected.

Role of Governments

Intensified global competition has put companies under greater pressure, and they are responding by investing only in the most favorable places. Countries should take this as a challenge rather than a threat if they want to win the battle for FDI.

Furthermore, policy liberalization alone may not increase competitiveness sufficiently. Economic opening is the necessary "stick" to force competition and shift resources to their most productive uses. Experience in many countries suggests that "carrots" – public support of efforts to make firms more efficient – are also urgently needed. For example, government assistance can help upgrade technology labor skills. Access to information and technical services, general education, and specialized industrial and managerial training is more important than ever.

"Public support" does not mean that governments should do, or even pay for, it all. To the contrary, many of the support services required by industries are best delivered by private institutions. Governments can no longer act simply as monopolies providing certain services or goods, or even simply as regulators; their functions must include those of assistant and partner.

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Review and Extension of *Heredity and Humanity*

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Heredity and Humanity: Race, Eugenics and Modern Science
by Roger Pearson
Scott-Townsend Publishers, Washington D.C. 1996

Pearson's book attempts to cover a vast amount of material, trying to summarize in one place the history of race, heredity, and eugenics. As a result it is an introduction to a whole series of interesting topics.

To this reviewer, some of the most interesting material is in the later chapters which cover contemporary developments in relation to the study of heredity and the potential for eugenic action to combat the dysgenic trends inherent in modern society, but this review will proceed chronologically. The first chapter, entitled "The Concept of heredity in the Ancient World," documents that from classical times until relatively modern times, Western scholars took it for granted that human character was influenced by heredity. The second chapter, which outlines the hereditarian interests of the Nineteenth and early Twentieth Century founders of modern science, describes the growing scientific basis for the idea that heredity matters, and its logical implication that who the parents of the next generation are affects the nature of that generation. Names such as Earnest A. Hooton, Ellsworth Huntington, R. H. Jennings, William McDougall, Lewis Terman, F. Giddings, Edward A. Ross, Robert M. McIver, Emory S. Bogardus, all pioneers in the founding of the social sciences, are mentioned.

This chapter shows that eugenics and heredity were mainstream ideas until the advent of World War II, and demonstrates the fallacy of the idea conveyed by the media that the ideas of that period were some kind of pseudo-science. They were mainstream ideas, which

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modern science is currently validating. In other fields, even when the ideas held by earlier scientists are found to need revision, we do not describe the early writers as pseudo-scientists, but regard them as pioneers (D'Souza, 1995). Only the prevailing media bias against the findings of behavior genetics can explain the distorted views as to the importance of genetics in shaping human behavioral tendencies.

Pearson's third chapter, entitled "Eugenicists as Conservationists," reveals how many of the early eugenicists were also conservationists, concerned about the preservation of the natural environment. The American Redwoods and Yellowstone Park were saved by people like Gifford Pinchot, Madison Grant, Henry Fairfield Osborn and John Campbell Merriam, and Francis B. Sumner. This is not so surprising since both viewpoints represent a concern by today's generations about problems that will predominantly affect the distant future, and unborn generations.

The fourth chapter, entitled "Race as a Nation-Building Ideal," traces the views of eminent figures from the first half of the present century who saw nations as breeding populations, and used such phrases as "race suicide" to refer to dysgenic trends affecting the quality of a nation's population. Pearson documents the views of authorities such as Sir Arthur Keith, Margaret Sanger, Sir Charles Galton Darwin, Dean Inge of St Paul's Cathedral, London, G. Stanley Hall, the president of Clark University, David Starr Jordan, president of Stanford University, and Theodore Roosevelt. These and many other notable names were deeply concerned about maintaining the genetic quality of the nation. It is interesting to see how eugenic laws, which many writers now dismiss with horror, were adopted by many European countries and U.S. states in the 1930s. The discussion here does not differ radically from that of other authors, except that Pearson shows how broad the support for eugenic policies was among leading academics at that time. He himself is obviously sympathetic to eugenics, while other writers openly display their antagonism.

After reaching a high point in the 20s and 30s, eugenics and the idea of heredity went into decline. Pearson attributes (in Chapter Five, entitled "Radical Egalitarianism Penetrates Academe") much of this to the extensive influence of the anthropologist Franz Boas and his disciples, followed by the impact of Stalinist Marxism. Very important was the defeat of National Socialist Germany, which led to opponents of heredity and eugenics implying, and often actually

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claiming, that acceptance of the importance of heredity implies that one must favor Nazi policies. Of course in pure logic, the position that Hitler believed X, and therefore anyone else who believed X must also support Hitler's policies is wrong. Yet, it is very striking how strongly "informed" opinion changed between the twenties and the fifties, in spite of there being essentially no new scientific evidence gathered that was relevant to the questions of race or eugenics. Possibly the most influential book which contributed to the new assertion that human beings were not genetically different, was *Coming of Age in Samoa.* This was written by one of Boaz's protegées, Margaret Mead, and is now known to have been factually false in many important respects.

Pearson does make what appears to be a mistake in asserting (p. 70) that "the idea of the biological equality of all mankind was a virtual necessity to political egalitarianism." I do not see this as being true, since it seems rather easy to argue for political egalitarianism without supporting biological egalitarianism, as Thomas Jefferson and other signers of the U. S. Declaration of Independence (who supported political equality) did, even though none of them appear to have been believers in biological equality.

Nevertheless, this section advances one of the most important ideas of the book. On page 78, Pearson writes that "Altruism had evolved because the survival chances of a population were enhanced when individual members were prepared to make personal sacrifices to protect the intergenerational well-being of their own kind." This states the well-established sociobiological argument that genes promoting "altruism" spread when the altruism promotes the survival of relatives who are likely to also be carrying the genes for altruism (Hamilton, 1967).

Many of what we regard as the noblest traits of mankind (and womankind) emerged while hominids lived in small bands. However, in large modern societies, self sacrifice usually does not encourage the survival of one's own genes, since much of the benefit is for those who are unrelated. Selection in a large modern nation is probably against altruism, including such traits as generosity, courage, patriotism etc. In the long run, if such traits are to survive in humans, some mechanism must be devised so that those lacking these traits reproduce at slower rates than the carriers of such traits. A modern, unregulated reproductive system is unlikely to accomplish this. The

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idea sometimes proposed of asking those citizens who are carriers of undesirable traits to refrain from reproducing has one unfortunate characteristic. This is that the only individuals likely to respond positively to this plea and refrain are those who are the most altruistic members of society – precisely those we would like to see reproducing!

Readers of this chapter might well wish to peruse another book by Pearson, namely his *Shockley on Eugenics and Race*. This reprinted 22 studies by the Nobel Prize-winner William Shockley on the current threat of dysgenic trends to American society. Besides containing a useful biographical summary of Shockley's academic work by Pearson, it also includes a valuable Introduction by the eminent psychologist Arthur Jensen.

The seventh chapter, "Media and Academic Persecution of 'Hereditarian' Scholars", of the historical section of this work draws on Pearson's earlier *Race, Intelligence, and Bias in Academe* (Introduction by Hans Eysenck), describing how in recent years scholars who argued for the effects of heredity, and especially for racial differences in ability, have been persecuted. It is important to realize that much of the present day belief that there are no economically important genetic differences between races arises not from any scientific evidence, but from a campaign of persecution against those who know otherwise, and from a media determined to present only one part of the evidence.

One of the more amusing incidences of this is in *Time* magazine (Subramanian, 1995). *Time* ran a review of Cavalli-Sforza's The *History and Geography of Human Genes* (a book on the distribution of genes, none of whom are believed to affect intelligence) under a heading "The Story in Our Genes: A landmark global study flattens *The Bell Curve* proving that racial differences are only skin deep." Actually, this book deals with differences in genes that are measured from blood samples (which are, of course, drawn from beneath the skin), and contains hundred of pages of maps and tables documenting that populations (including races) differ in characteristics that are other than skin deep.

The writer of this review has reviewed both books (Miller 1994d, 1995b) and can speak confidently of their contents. *The Bell Curve* is a book about intelligence. Reference to the 10 page index of *The History and Geography of Human Genes* shows it lacks even an

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entry under intelligence. It never discusses the concept. Notice that getting the subject matter of a book right is much easier than determining whether rather technical scientific arguments are correct or incorrect.

Another example was a *Time* (Gibbs, 1995) cover story on Goleman's new book *Emotional Intelligence*, which claimed that intelligence is completely distinct from ability to defer gratification. It describes experiments in which a child had to choose between gratification now or in the future. In these studies the child's ability to defer gratification was shown to influence his life chances (correctly). It praises the scientist who developed this test, which reportedly measured a trait different from intelligence (p. 62). Yet the scientist praised had investigated the relationship of the trait studied to intelligence, and had shown that the more intelligent children were also better equipped to defer gratification (Mischel & Metzer, 1962). In both of these cases a letter to the editor (by the author of this review) pointing out these simple factual errors was not published.

The latter half of Pearson's book is perhaps the more important because it discusses some of the modern scientific evidence that relates to heredity, race, and eugenics. Chapter VIII, entitled "Twin Studies, Blood Group Research and Modern Genetics" discusses some of the modern evidence as to the importance of heredity, mentioning that (p. 93) "*The Bell Curve* had a major impact on the public and scholastic world alike – despite what appeared to be an organized and devastatingly adverse media reaction by committed egalitarians who saw their moral base crumbling beneath them." Surely, Pearson should have said "scientific base". However, it would seem from the general tone of his writing that he demands that valid moral systems should be in harmony with objective reality and, in that sense, with the forces of evolution. In short, he demands that valid moral systems should take into consideration the welfare of posterity, not just the interests of the present generation.

The discussion here suffers a little from the fact that research into human heredity is advancing so rapidly that any book on the subject can hardly be completely up to date. While Pearson mentions Rushton's (1995) work on the evolution of racial differences, Miller's (1994b, 1995a) paternal investment explanation for the same facts are not mentioned. Nor is the mathematical showing in this journal

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(Miller, 1994c) that in principle racial and sexual differences in population means are relevant to making optimal decisions about individuals, something that many had thought was irrational, and a sign of "prejudice". There is actually a mathematical proof that taking race into account will in general be necessary if the goal is to select the best qualified individuals.

In chapter nine, Pearson summarizes what is known from modern DNA research about the different populations or races which have played an important role in the history of human evolution. Some of the strongest evidence comes from Cavalli-Sforza et al.'s (1994) massive work. As I pointed out in a long review and summary (Miller, 1994d), although this book contains a short "politically correct" section critiquing the usefulness of the idea of races, its dust cover shows a multicolor map of the world drawn solely from genetic data (no skin color or morphological data). Remarkably, each of the major races of mankind can be recognized in its traditional locations and with its traditional boundaries.

The next chapter presents a brief discussion of the Human Genome Project, in which Pearson notes the probability that increased knowledge of human genetic diversity will undermine the case for biological equality of all races. So fast is molecular genetics advancing, that this newly published book is a little too old to recognize the extent to which this has already happened. Already several discoveries have been made, using modern methods of genetic research, showing that differences in alleles (varieties of genes) affect behavior. Meanwhile, in what is generally a separate literature, evidence exists that these alleles differ in frequency between different populations and races. This finding of population differences was to be expected because so far all alleles that differ within a population appear to differ in frequency between populations (see the extensive tabulations in Cavalli-Sforza et al., 1994).

Shortly after Pearson completed his book, the first evidence from molecular genetics bearing on racial differences in intelligence appeared. Skuder, et al (1995) reported evidence that a particular mitochondrial DNA allele was associated with intelligence. The allele, which was reported to lower intelligence in Caucasians, has been reported elsewhere (Scozzari et al, 1988) to be absent in sub-Saharan African populations. While this first molecular genetic evidence for racial differences in intelligence appeared to favor Negroids (perhaps

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fortunately for the continuation of such research), the possibility that different populations and races might benefit from different intelligence raising alleles is provided for in at least one recent theory for the origins of racial differences in intelligence (Miller, 1 996).

Another allele is known to affect IQ in older people. This is apolipoprotein E, whose effect is exerted through increasing the incidence of Alzheimer's disease. However, it is also known to affect mental performance in older individuals diagnosed with the disease (Reed, 1995), and evidence exists suggesting an effect on IQ in younger individuals (Plomin et al., 1995). Keltikangas-Jarvinen, Raikkonen, & Ki, (1993) have reported that this same allele affects temperament in children. As their abstract puts it, "Motor activity, even hyperactivity, in childhood and mental vitality in adolescence and young adulthood increased significantly with the apo E phenotypes in the order of E2/2, E3/2, E3/3, E4/3, and E4/4." It is known to differ in frequency among populations (Kamboh, 1995, Table 2), being least common in Mongoloids and most common in Negroids, with Caucasoids in between.

As for specific abilities, Berman & Noble (1995) have reported that a specific allele affects performance on a spatial ability test which differs in frequency among racial groups. A specific allele affecting the body's processing of alcohol appears to explain virtually all of the racial difference between Caucasians and Orientals in alcoholism (Tu & Israel, 1995). This appears to be the first racial behavioral difference to be understood at the molecular genetic level. Meanwhile, Pearson cut the discussion in his book off just before the publication of perhaps the most important evidence that racial differences in intelligence had a genetic origin (although he did work in a footnote on p. 96). This was the showing that black children adopted into white families differed from white children adopted into white families by 17 IQ points, slightly more than the amount by which black children reared in black homes fall below the IQ of white children raised in white homes (Levin, 1994; Lynn, 1994). Jensen (1994), working at the University of California at Berkeley, showed that the tests that measure intelligence best are those most sensitive to head size differences, and that the tests that are most sensitive to head size show the largest black/white differences.

Jensen and Johnson (1994) studied head size and intelligence in black and white children, males and females, using the very large

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data base from the National Collaborative Perinatal Study. Its importance is not merely in showing that brain size and intelligence co-vary. (This has been shown in several recent studies using MRI measurements of brain size), or that there are racial differences in head and brain size (this has been shown by autopsy data) (Rushton and Ankney, 1996). Comparing siblings, Jensen showed that the large-headed tended to be the more intelligent in black males, black females, white males, and white females. This result indicates that there is something biological (almost certainly genetic) that affects both brain size and intelligence. (Miller, 1994a, argued that this biological factor affecting both intelligence and brain size could be the thickness of layers of myelin). By showing that much of the racial difference in IQ disappears when children of the same head size are compared, Jensen and Johnson provide strong evidence that whatever is causing the racial head size differences is also causing at least part of the racial differences in intelligence.

Pearson's penultimate chapter, "Eugenics and Modern Medical Science," deals with modern medicine and eugenics. Paradoxically, although eugenics has become virtually a banned word since the twenties and thirties, when it was in fashion, the scientific case for it appears to have become stronger, not weaker. When eugenics was first popular, selection was viewed in terms of survival of the fittest, and selection was for disease resistance, strength, and intelligence. Among the chief obstacles to continued genetic improvement that have since emerged are misplaced altruism; the fact that modern medicine helps the survival and reproduction chances of those with genetic defects that once would have been eliminated from the gene pool; the fact that modern warfare tends to eliminate the fittest from each generation, and the fact that economic forces are causing the more intelligent to reproduce at less than replacement levels.

Modern evolutionary theory places a greater emphasis on not merely the survival of the fittest, but on the reproduction of the fittest. Modern behavioral genetics suggests that altruism, like other personality traits, is genetically influenced (Rushton, 1980), with some having more of the genes for this than others. Meanwhile, a theory has appeared explaining why genes for altruism have survived in humans. Humankind traditionally lived in small groups, in which altruism frequently benefited close relatives, who would also be carrying the genes for altruistic behavior. In a large, complex society,

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altruistic behavior is much less likely to benefit relatives. Altruistic behavior today is probably being selected against, and can be maintained only by action to discourage reproduction by those lacking the genes that lead to altruism.

In recent years modern medicine has provided a new dysgenic threat in the form of birth control. Persons endowed with reasonable intelligence and the ability to defer gratification tend normally to have children only when planned. However, those of very low intelligence, or with a weak ability to defer gratification (by stopping lovemaking to practice birth control), are likely to have unplanned offspring, both in and out of marriage. Yet the ability to defer gratification appears necessary for civilized life. Thus, the advent of birth control has created a new dysgenic trend in the advanced societies.

In his last chapter, "Genetics and the Future of Humankind", Pearson present the modern case for eugenics. In this reviewer's opinion, the argument for a eugenic policy can perhaps be made even more strongly then he has made it. In the long run, biology suggests there will be some type of limitation of population growth (no population can keep growing forever, and human fertility is such that prosperous populations can be expected to grow). This will be either by government regulation or by Malthusian checks. Voluntary restraint won't work because it will simply select against those altruistic enough to restrict their number of children. Government regulation does require that some decisions be made as to how many children each adult should have.

Given the close relationship between IQ and economic and social success (Herrnstein & Murray, 1994), and between certain personality traits and economic and social success (Goleman, 1995), it seems obvious that efforts should be made to increase the fraction of children blessed with the desirable genes. While Pearson seems right to warn us of the dangers of having a government bureaucracy decide who will bear children (p. 140), there seems to be no alternative which is consistent with maintaining the sort of gene pool that will permit the continuation of modern civilization, with its need for high intelligence, ability to defer gratification, and altruism.

Readers should be warned that Pearson's book will be attacked as racist, in that he shows how the evidence for genetic differences between races is becoming wider rather than narrower, and those who

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on principle do not read such literature will probably avoid it. Others will find much thought-provoking material in it.

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BOOK REVIEWS

Transitions in Land and Housing:
Bulgaria, The Czech Republic, and Poland
Ann Louise Strong, Thomas A. Reiner, Janusz Szyrmer
St. Martin's Press, New York. 1996

This study seeks to describe the shift in control of land and housing from the public to the private sectors in these countries in the context of their transitions from communism to market democracy. Under communism, private markets, private ownership of productive assets, and landlord status were anathema. With the post-1989 transition to market economies and democratic societies, major structural and legal changes have taken place in Central and Eastern Europe. Choices about purchase, use, and sale of land and housing are once again made largely by private owners, not the state. Real estate markets have been reestablished. Most people, as owners of property (farms, apartments, houses, shops, shares in enterprises), now have a stake in the system – but this transition is not without costs. Housing construction has plummeted, some farm lands lie fallow, housing credit and farm credit rarely are available, and the poor and elderly fear loss of the social safety net.

Bulgaria, the Czech Republic, and Poland have responded to the challenges of transition in distinct ways, each state influenced by its pre-communist past and by the extent of its power under communism. Strong, Reiner, and Szyrmer trace the struggle for control over real property in the transition process. There can be no doubt that revolutions change established patterns of economic evolution and create conditions under which it is extremely difficult for normal patterns of free market exchange to re-establish themselves without enormous inequities. The opportunities for "carpet-baggers" are almost as great after the overthrow of a revolutionary government as they are after the initial victory of revolutionary movements. Contentment depends to a very large extent on stability, and Pareto's "speculator elite" are never so happy as when a "rentier elite", of either the right or the left, are overthrown.

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The Ukrainian Challenge:
Reforming Labour Market and Social Policy
ILO Central and East European Team
Central European University Press, Budapest
Distributors: Oxford University Press, New York. 1995

The Ukraine was one of the largest East European countries that acquired independence in late 1991. But having been integrated for so long into first Czarist Russia and then the Soviet empire, it did so under the most difficult of circumstances. Between 1991 and 1994, its economy went into a state of hyper-stagflation – a combination of massive economic decline and an inflation rate that rose to above 10,000 percent in 1993. Its political and social infrastructure had to emerge against the background of rapidly shrinking living standards and concern about the sustainability of the country itself.

Remarkably, in mid-1994 Ukraine seemed to have established the necessary political basis for a sustained transformation of its social and economic policies. In the coming period, it will be essential for the government, for those agencies providing financial assistance, for the emerging employer and trade union organizations and for others involved in that process to give very high priority to the substantial reform of labor market and social policy.

Open unemployment mounted in 1994-95, poverty is already widespread and severe, life expectancy has fallen from what was an already low level, the aftermath of the Chernobyl nuclear accident is still having profound social effects and will continue to do so for many years; above all, in the foreground, is the need to address the social and labour market consequences of restructuring the economy away from its overemphasis on production for military purposes.

This report is the responsibility of the ILO's Central and Eastern European Team, based in Budapest. It was prepared in cooperation with the United Nations Office in Ukraine and many Ukrainian governmental organizations, trade unions and employers' organizations, and as such is specifically concerned with the interests of its backers – with labor. It consequently attempts to assess the trends in social and labor market policy currently emerging in Ukraine. Given this perspective, it provides valuable data which might otherwise not have been presented to the public in such comprehensive form.

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Women and Market Societies:
Crisis and Opportunity
Barbara Einhorn and Eileen Janes Yeo
Edward Elgar, Brookfield, U.S. 1996

Women and Market Societies explores the impact on women of the transition to a market economy in East Asia, the dismantling of state socialism in Eastern Europe and the restructuring of the economies and welfare states of the older capitalist market societies in Western Europe. Its authors adopt an outright feminist viewpoint, and its data is somewhat oriented toward their ideological concerns. However, there is much of interest in its pages.

Questioning whether the global trend towards market economies will constrain or enhance women's opportunities, the authors show how the collapse of communism in China has weakened the family in tending to treat individuals as self-oriented economically-motivated beings. The men, it claims, are increasingly ignoring their loyalties to wives and families and searching for sexual satisfaction with available younger women.

On the other hand, in Eastern Europe the decline of the communist state has tended to strengthen the family as the only unit capable of withstanding the brunt of raw capitalism untempered by traditional pre-Communist mores. Liberated from the concept of the universal Soviet being, the people have become free to express an interest in their ethnic identity, and the family is an institution intimately associated with, one might say fundamental to, the ethnic nation. The authors do not seem to approve of this, but the evidence for it comes through in the examples they cite. Unfortunately the authors tend to place men and women in opposing camps, and more than that, to see nations primarily as barriers to international feminist solidarity.

Absorbed with their own ideologies, and seeking to judge the standing of women largely in terms of economics and "empowerment", the authors have sought to examine the changing role of women in non-Western as well as Western societies, but are unable to themselves fruitfully handle data which are truly of great sociological and political significance. Despite this drawback, however, the book is of value because its subject matter is fraught with implications for the future.

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Adam Smith's System of Liberty, Wealth and Virtue:
The Moral and Political Foundations of the Wealth of Nations
Athol Fitzgibbons
Clarendon Press, Oxford. 1995

Author Fitzgibbons here seeks to analyze the influence of Adam Smith's philosophy on his economic theories. He considers the significance of Smith's Stoic beliefs, and examines his theories of art and science, of law and rhetoric, and of history, politics, and war. It shows how Smith based his system of thought on the moral notion that virtue was relevant to this world rather than the next. Smith believed that unworldly philosophies were inherently authoritarian because they were unable to harness the force of self-interest productively. Yet, contrary to a common view, he also rejected the amoral liberalism advocated by his friend and countryman David Hume.

Fitzgibbons, who is an Associate Professor at Griffiths University in Australia, argues that Smith's theories of free trade, economic growth, and alienation, which constitute the substance of *The Wealth of Nations*, derived from his interpretation of Stoic virtues, which saw virtue as something quite distinct from utility. He then proceeds to show how Smith's economic theories were subsequently isolated from his philosophy and adapted to promote ends other than his own. The book is clearly written; it puts Smith's theory of economic growth in a new light, and reveals the philosophical concepts which inspired his world view.

Science, Technology, And Ecopolitics in the USSR
Miron Rezun
Praeger Publishers, Westport, CT.

Although enormous industrial advances were made in the USSR, the country still lagged behind the West in the post-industrial age. What the Soviets could not build or manufacture, they had to acquire, often by cloak and dagger methods, from the West. The final outcome was a culture developed in which there was no regard for consumerism and, particularly sadly, no respect for the environment. The Soviet achievements in technology and manufacturing, made

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easier as they were by the rich legacy of Siberian resources they inherited from the Czarist empire, were achieved largely at the expense of the environment, which they exploited ruthlessly and without regard for future generations.

The author, who is a professor at the University of New Brunswick, traces the development of the Soviet malaise, but warns that a future authoritarian regime could still revive the technological arms race. Conversely, he also replies to the academic debate on the excesses of modern technology in the West, with a sharp criticism of feminist and post-modernist perspectives.

Market Unbound:
Unleashing Global Capitalism
Lowell Bryan and Diana Farrell
John Wiley and Sons, New York 1996

The profit opportunities available today in the global capital markets are so large, and the capital seeking those opportunities is so vast and so highly mobile, that we are entering into an entirely new era of capitalism. The process of globalization has been going on gradually for decades, but the world's capital markets have now reached critical mass. In the absence of national ideologies and mercantilistic traditions they are poised to fuse into a single global capital market, and we are about to enter into an era of dramatic economic change. The link between national ownership of national resources and industry declines, the entire structure of industry and trade is being reorganized.

Market Unbound strongly focuses on a future world economy which it sees as unstoppable. It openly advocates the supremacy of international organizations over national interests, and sees the diverse peoples of the world not as competing populations but as world citizens organized under an international capitalist supreme government of financiers. It seeks to provide a blueprint of this challenging new global market, which it sees as economically advantageous. Authors Bryan and Farrell explore the enormous effect this revolution will have on governments, corporations, and individual investors. Although the global economy has already undergone major and irreversible change, the transformations yet to

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come promise the most significant economic developments since the Industrial Revolution. In the uncertain future, one thing is clear: the global capital market is increasingly dictating the actions and policies of governments, as opposed to governments dictating the actions and policies of the market.

There is, without question, the authors maintain, promise of great prosperity as rapid growth takes hold in both the developed and underdeveloped world. But the result will inevitably be changes in the pattern of investment which will result in a vast redistribution of wealth and massive unemployment in areas which were formerly prosperous. They also ignore the problem of the Third World population explosion, which might well wreck the political stability necessary for economic stability. The future will inevitably breed turmoil and social unrest, as whole populations see their comparative standard of living decline while those of other regions rise.

Based on extensive research conducted by McKinsey & Company, Inc., a major consulting firm, the authors:

· Explore and define the dynamic impact the converging markets will have on every sector of society

· Reveal how the foreign exchange and bond markets are integrating to the point where they are fundamentally acting as one

· Explain how financiers may seek profit and avoid loss in the impending economic climate

· Reveal how a government's ability to exercise control over its own financial system is being undermined by the global capital market

Assuming always that there are no catastrophic reactions (i.e. international wars or civil revolutions), which vast changes in the distribution of wealth and investment might well provoke as the global capital market continues to advance, those countries which are most likely to benefit, namely the nations of Southern and Eastern Asia, will find the opportunity for tremendous gain; others will face catastrophic losses. This is a truly thought-provoking book which should be read, not uncritically, by all who seek to understand the implications of the powerful forces currently modifying the international economy at a tremendous rate.

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The Politics of Economic Reform in Zimbabwe: Continuity and Change in Development
Tor Skaines
St. Martin's Press, New York. 1995

The success of the leftist guerilla forces in their struggle to seize control in Rhodesia from the white government, aided by the full weight of the international community and the rapid explosion of the black population as a result of Western medicine and prosperity resulting from the success of the white-owned farms and mining operations, at first led many to fear that Zimbabwe, as Rhodesia was renamed, would reach the same economic and political fate as Zambia, the former Northern Rhodesia – near-total collapse. However, the history of Zimbabwe has more closely followed that of Kenya. Just as in Kenya a bloody terrorist faction won control of the new independent government, and then had the sense to recognize that the prosperity of the country depended upon retaining the white advisors and farmers who alone were qualified to preserve the prosperity of the economy, so Zimbabwe, politically committed as its new leaders appeared to be to far-left doctrines, chose to maintain an atmosphere in which the white farmers and industrialists would remain and continue to operate, while suppressing disruptive Leftist forces which demanded aggressive workers' unions and major reallocation of land to the inefficient but exploding black population.

Initially there was some turmoil, but in 1990 Zimbabwe embarked on economic liberalization. The country's economic associations, notably that erstwhile proponent of protectionism, the Confederation of Zimbabwe Industries, had successfully lobbied for gradual reform. While state-dictated economic programs have in most self-governing black African countries often been regarded as a vital condition for reform, in Zimbabwe societal groups have induced the initially socialist-committed government to reconsider its basic ideologies. After independence the government restricted political competition, but because of the perceived need for white industry and commerce, it had the sense to maintain a dialogue with white entrepreneurs along the pattern of societal corporatism established in the 1930s. By contrast, African associations, particularly the labor unions, which would have promoted courses of action which would have brought ruin to the country were strongly regimented. The

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government, however, faces political difficulties in the agricultural sector due to the demands of the burgeoning population for the redistribution of land away from the efficient white farmers and into the hands of less efficient and undercapitalized blacks. In Zimbabwe key urban groups support economic liberalization while key rural groups do not.

Just as Kenya was successful in maintaining prosperity under the dictatorial management of former terrorist leader Jomo Kenyatta, but has more recently suffered severe economic reversals because of the political instability which followed his demise, so one wonders how long Zimbabwe, rich though it is in natural resources, will be able to manage the problems of population pressure once the authoritarian government of the ex-terrorist factions is replaced by more truly democratic political institutions.

The Andean Cocaine Industry
Patrick L. Clawson and Rensselaer W. Lee III
S. Martin's Press, New York. 1996

The Andean nations of Colombia, Peru, and Bolivia are the international centers of cocaine production. Every day we read reports of murders, seizures by U.S. customs, and sophisticated drug trafficking schemes, but how much do we really know about the international cocaine industry? Clawson and Lee examine the local politics that drive the world's cocaine industry. They uncover the economic and political factors that make the cocaine industry so lucrative, but also the most dangerous occupation in the world.

Finally, the authors ask, what can be done to shrink the Andean cocaine industry? The drug industry not only destroys the lives of untold numbers of individuals, but it also weakens the well-being of entire nations. At the same time the profits made from this industry place control over ever-increasing mountains of wealth in the hands of totally unscrupulous individuals, so that ownership of even legitimate industry and commerce is likely to fall progressively into the hands of persons who are deeply dishonest.

The effectiveness of the U.S. war on drugs is considered, and in conclusion the authors offer suggestions for improving the U.S. campaign against cocaine trafficking.

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Heredity and Humanity:
Race, Eugenics and Modern Science

Roger Pearson, Ph.D.

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THE DISPOSSESSION OF THE AMERICAN INDIAN – AND OTHER KEY ISSUES IN AMERICAN HISTORY

Dwight D. Murphey, Ph. D., J.D.

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